TAX LAWS AND THEIR IMPACT ON AGRICULTURE

HEARING

BEFORE THE

SUBCOMMITTEE ON DEPARTMENT OPERATIONS,
RESEARCH, AND FOREIGN AGRICULTURE

OF THE

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HOUSE OF REPRESENTATIVES

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[1] Effective only for the first session of the Ninety-ninth Congress.

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TAX LAWS AND THEIR IMPACT ON AGRICULTURE

FRIDAY, MAY 31, 1985

House of Representatives,
Subcommittee on Department Operations,
Research, and Foreign Agriculture,
Committee on Agriculture,
Mason City, IA.

The subcommittee met, pursuant to call at 9:15 a.m., in the Beem Center, Northern Iowa Area Community College, Mason City, IA, Hon. Berkley Bedell (chairman of the subcommittee) presiding.

Present: Representatives Penny and Evans of Iowa.

Also present: Representative Lightfoot.

Staff present: Timothy J. Galvin.

OPENING STATEMENT OF HON. BERKLEY BEDELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. **Bedell**. The subcommittee will come to order.

The House Agriculture Subcommittee on Department Operations, Research, and Foreign Agriculture meets today under rule X, clause 2(d) of the House of Representatives. That clause states that, "Each standing committee of the House shall have the function of reviewing and studying on a continuing basis the impact or probable impact of tax policies affecting subjects within its jurisdiction."

This morning, the subcommittee intends to review two general areas relating to taxes and agriculture. The first is an issue on which I have heard from dozens of farm families over the past several months: the impact of our Tax Code in putting true family farmers at a competitive disadvantage with outside investors in agriculture who may benefit disproportionately from farm-related tax provisions.

The second matter is the issue of the tax consequences faced by farmers who, because of the depressed state of our farm economy, must dissolve their operations.

I have received letters and phone calls from many individuals who, despite being forced out of agriculture for lack of income, nevertheless find themselves subject to a minimum tax or recapture of past tax breaks when they dispose of land, livestock, or machinery.

There is substantial evidence which raises troubling questions about the role of our Tax Code in shaping the structure of agriculture.

According to the Council of Economic Advisers' 1984 report to the President:

> Tax policy does not affect the profitability of all types of farms equally. The tax laws encourage the substitution of capital for labor. Larger farms, which generate higher incomes, appear to gain proportionately greater benefits than small farms. People in higher marginal tax brackets can benefit more from the tax provisions. This creates an incentive for higher income people to invest in farming. In practice, losses from farm operations reduce taxes on other income by more than the total Federal tax revenue from farm profits, implying that total farm income for tax purposes is negative.

In addition, a recent study by the U.S. Treasury indicates that the writeoffs against taxes on income from nonagricultural sources due to losses in agriculture are nearly twice as great as the taxes which farmers pay on their agricultural income.

On March 29 of this year, I was joined by 41 of my colleagues in the House—including Congressmen Cooper Evans, Tim Penny, Jim Lightfoot, Tom Tauke, Jim Leach, and others—in sending a letter to the chairman of the House Ways and Means Committee, Dan Rostenkowski, asking him to hold hearings to examine the impact of our tax laws on agriculture.

I am pleased to report that on April 24, I received a letter from Chairman Rostenkowski stating that it was his intention, in the course of the hearings he anticipated on comprehensive tax reform, "to undertake a review of the impact of our tax laws on American agriculture." Those hearings have been scheduled for Monday, June 24.

As we all know, just 3 days ago the President went on national television to announce his proposal for reshaping and simplifying the Tax Code. His proposal now joins other tax simplification measures which already have been introduced in Congress.

Clearly, the outcome of this debate could profoundly shape not only agriculture but our entire economy. In this respect, our hearings this morning should prove very helpful to us as we evaluate these tax proposals and their likely impact on our rural economy.

I want to welcome everybody to this subcommittee meeting this morning. I look forward to hearing our witnesses on this important and timely topic, and I am particularly pleased to have our colleagues, Tim Penny and Cooper Evans, with us here, both of whom serve on our Agriculture Committee and my subcommittee with great distinction.

Cooper, do you have a statement you would like to make?

Mr. **Evans** of Iowa. I have no formal statement, Mr. Chairman, but I want to thank you for convening the hearing this morning and to say that I'd like to associate myself with the remarks in your opening statement.

Mr. **Bedell**. Thank you very much.

Tim.

OPENING STATEMENT OF HON. TIMOTHY J. PENNY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. **Penny**. Thank you, Berk.

I, too, appreciate your willingness to convene this hearing. I think it's terribly important that our committee, the Agriculture

Committee, have direct input to the Ways and Means Committee as they begin their work on tax reform.

The concerns we have for the family farm structure ought to be reflected in the work of the Ways and Means Committee as it writes a tax reform proposal.

I'm convinced, as I know you are, and others on our committee, that there are certain elements in the existing Tax Code that work to the detriment of family agriculture, and if we're going to pass any kind of tax reform legislation this year, we ought to clean up that code in a way that's beneficial to the family farmer, and I think this hearing is a step in that direction.

Mr. Bedell. Thank you, Tim.

Our first panel consists of Dr. Mike Boehlje of Ames, IA, State University; James Shepard of Allison, an Iowa attorney; and David Bibler of Algona, another Iowa attorney.

We will hear from you, Dr. Boehlje. We appreciate your coming up from Ames for this.

STATEMENT OF MICHAEL D. BOEHLJE, ASSISTANT DEAN, COLLEGE OF AGRICULTURE, IOWA STATE UNIVERSITY

Mr. Boehlje. Thank you very much, gentlemen. It is a pleasure to be here to visit with you about this important issue of tax policy.

I'd like to make, in the brief time we have, about 10 or 12 key points, and I'll keep them cryptic and then respond to questions.

The first point is that, as we're looking at tax policy, it seems to me we need to focus on the tradeoffs between what I guess I consider six different issues.

The first is the tax burden of a sector of the economy vis-a-vis other sectors: What is the tax burden in agriculture compared to other sectors? I'm thinking now more broadly of, for example, the administration's or other proposals to modify significantly the tax law.

Second is the distribution of that burden within the sector, not only enterprise distribution but also the distribution vis-a-vis farmers with high versus low incomes.

The third issue is the sheltering issue, the issue of the sheltering of income from taxation.

The fourth issue is simplification, making the tax law easier to work with.

The fifth issue is the issue of incentives to alter behavior on the part of individuals, frequently in the area of investments in capital-intensive facilities or other types of economic activity.

The final issue is the issue of revenue generation.

Any changes we make in the tax law, it seems to me, we have to face those six issues and face the fact that in some cases, to get one, we have to give up on one of the others.

Particularly, as we'll talk later about some of the flat tax concepts, it seems to me that that tradeoff has not been explicitly recognized. That's point number one.

Point two is that we have had significant studies done over the last 5 to 7 years indicating that there has been a lot of tax sheltering going on in agriculture.

I was involved in a USDA study published in the early 1980's as part of the structure of agriculture components, spent 6 months in Washington chairing work on tax policy and tax and structure of agriculture, and we concluded in that study that the Tax Code encourages farm expansion, capital-labor substitution, increased debt utilization, and outside investment.

So I think that study, along with the studies that you quoted, suggests to us very clearly that taxes have had a significant impact on economic behavior in agriculture on investments, on management decisions, et cetera.

So it is important that we look at those tax laws to make sure that they are not having adverse impacts on the sector.

Tax sheltering occurred on the part of both farmers and nonfarmers in the 1970's, and I want to underline this because a lot of the dialog with respect to the issue of changing the tax laws focused on the nonfarmer incentives to shelter income in agriculture.

But, in reality, during the 1970's, a lot of farmers sheltered a lot of income through the use of the tax law, and a relevant question is, is that acceptable whereas nonfarm sheltering is not acceptable? I don't have an answer. I think it is, however, a very legitimate question.

That sheltering occurred through the use of the common cash accounting system, the investment tax credit, accelerated depreciation, conversion of ordinary income into capital gains, and those, I guess, are the four key tools that this sheltering occurred with.

So point three is, tax sheltering was dominant and heavily utilized in the 1970's but not exclusively by nonfarmers. It was utilized heavily also by farmers to shelter income.

The opportunity to, as we sometimes say, mismatch income and expenses through the tax law was very, very effective for many farmers to be able to report significantly less income for tax purposes than the economic income that they would generate.

I guess what I'm trying to say is that it's not necessarily farmers had white hats in this phenomenon and everybody else had a black hat.

Today, most tax sheltering is occurring, however, on the part of nonfarmers, and it's very clear why that's the case, and that's because farmers simply don't have low enough incomes to have sheltering or even tax burdens to worry about in many cases.

So the focus on the sheltering activity of nonfarmers in today's environment may be legitimate, but, on the other hand, let's recognize that in history, in past periods of time, the sheltering has occurred on both sides.

Point four is that there may be two reasons for tax sheltering—tax breaks, if you will. At least it seems to me, we have historically justified these two basics.

The first is to encourage some type of economic activity. Frequently, we give tax shelters to certain industries to encourage investment, and that's the justification for an investment tax credit, the justification for accelerated depreciation, mechanisms to encourage modernization of industry, et cetera.

The second is that we sometimes use these tax breaks as a mechanism for just basically lowering the tax burden for a particular set of firms or a particular industry. We feel that there is justification, that their tax burden is too high, and it needs to be lowered, and so we give them certain kinds of tax incentives.

I would suggest to you that neither one of those arguments is applicable to the agricultural sector today—that is, that we don't need tax breaks for agriculture to encourage investment, to encourage new capital investments, because the industry, we feel, is overcapitalized—and, second, we don't need tax breaks to reduce the tax burden for agriculture because, again, as we noted, the tax burden of agriculture is very, very low because of the losses the industry has.

So it may be, in that sense, an opportune time to make some changes, because, in fact, justifications, political or otherwise, for these tax breaks of the 1950's, 1960's, and 1970's are not the case today.

The next point I'd like to note is that it seems to me that this whole issue, from a perspective of restricting the use of tax losses in agriculture to offset income from other industries, has significant merit and is something we ought to very seriously consider.

It doesn't appear to me that there is much justification for having one sector of the economy be able to, in a sense, take advantage of another sector of the economy through the tax law.

So I think some of the proposals to restrict the opportunities to offset losses in agriculture against income generated in other sectors of the economy have significant economic benefits, significant equity benefits, and, it seems to me, ought to be seriously pursued.

I would raise the question that restricting the tax sheltering by farmers themselves may also be a legitimate issue. Now, again, as we've noted, it isn't as critical an issue today, it clearly is a more controversial issue, but it seems to me very appropriate to consider.

One of the key issues here that we would look at is the issue of the use of the cash accounting system by most farmers except under very unique situations.

One might argue that if tax sheltering occurs on the part of farmers and on the part of the farmers who have the most incentive—those in the high tax brackets who have high levels of incomes—that there may be some reasons to restrict the use of the cash accounting vehicle, which is the major mechanism for doing the tax sheltering on the part of farmers, restricting that vehicle to certain levels of income so that, as a matter of fact, those with very high incomes and very high tax brackets don't have access to that tool for tax sheltering within the farm sector.

That, obviously, is a much more controversial issue than the issue of tax sheltering on the part of people outside the agricultural sector.

We should note very quickly that the proposals that are frequently discussed now to reduce the rates of particularly the upper brackets will significantly decrease the demand for tax sheltering assets.

So one of the advantages of any proposal that lowers rates is that it just makes tax sheltering less desirable, and there's a lower payoff to it, and so it could be that that may be one of the significant ways to eliminate or reduce the incentive for tax sheltering.

However, there are reasons to believe that previous changes in the tax rates—lowering of the tax rates—have been combined with changes in the deductions and exemptions such that the increased deduction improved tax sheltering more than the rate reduction decreased the incentive for tax sheltering.

It seems to me that part of the administration's proposal, whether you look at Treasury I or the one that was just recently introduced, does have some elements of rate reduction and eliminating some of the incentives for tax sheltering.

I should note that the discussion of a modified flat tax, which is, again, part of the administration's proposal, seems to me to have significant merit, but the real issue in the modified flat tax question is the tradeoff between the base broadening aspects of those proposals and the rate reductions.

If you're going to maintain the same amount of revenue, you can't do it in any other fashion than to change the base upon which those rates are going to be applied if, in fact, you're going to reduce the rates. It just isn't possible to do it in any other fashion, at least that I'm acquainted with.

If the base broadening occurs extensively in the sector—by base broadening I mean eliminating deductions, exemptions, credits, et cetera—it's possible that the sector will actually pay more taxes, and, as a matter of fact, our studies of some of the early flat tax proposals that would set a flat tax 17, 18, 19 percent in a single flat tax resulted in the sector paying more taxes as a whole than under the current set of rules.

That may be acceptable, but it's important to know that, that in fact the agricultural sector was going to pay more taxes, and, furthermore, there is a redistribution of that tax burden with some of those pure flat tax options where the higher income taxpayer pays significantly less tax and the lower income taxpayer pays more tax.

So these issues are not really sometimes discussed in the flurry to endorse flat tax concepts that we not only have the possibility of a sector paying more tax, which we think is a possibility, but also a redistribution of the tax burden within that sector.

I guess what I'm suggesting is, I would caution you that we need to make sure that these proposals don't have that impact or at least be aware of it in our choice.

We have to recognize that agriculture, as a sector, has been tax favored. So many of the flat tax proposals or modified flat tax proposals and the simplification rules will result in an increased burden. I think that's something that we'd probably better recognize up front, that the sector probably will end up paying more tax because it has been significantly tax favored in the past.

I just would comment briefly about the President's proposal, and I think it's really too early to evaluate it in a lot of detail, but I would indicate to you that there are some significant issues that I think need to be looked at.

For example, the issue of the nondeductibility of State and local taxes is not clear to me. Some questions here suggest that they may be deductible if, in fact, they are business expenses, and yet, at the same time, it's not clear how you start defining business expenses. I'm thinking particularly in terms of property taxes.

I think that's something that definitely needs to be clarified, because if that is a broad-based nondeductibility, agriculture and real estate in general will be significantly impacted by that, and we get into a very significant issue in terms of how you define business versus nonbusiness expenses in terms of that issue.

Clearly, the proposal does not reduce tax sheltering as much as Treasury I did, and yet I guess what I would suggest is, we need to be careful that in our desire to reduce tax sheltering, we don't, on the other hand, result in a significant increased tax burden for the sector that we're trying to protect from sheltering.

I'd be happy to respond to any questions you might have.

Mr. BEDELL. Thank you very much, Doctor.

We have been joined by Jim Ross Lightfoot, our colleague from southwest Iowa.

Do you have a statement, Jim, that you'd like to make?

STATEMENT OF HON. JIM LIGHTFOOT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. LIGHTFOOT. Thank you, Mr. Chairman.

Congressman Evans, I'd like to thank you for giving me the opportunity to appear here this morning at this very important hearing.

In order to save time, I'll make my comments short and just ask that my prepared statement be entered in the record.

Mr. BEDELL. Without objection, it will be entered in the record.

If anybody has prepared statements, they will be entered in the record, and people may summarize, as they wish.

Mr. LIGHTFOOT. Mr. Chairman, basically, I think we all know we're faced with some very severe problems in agriculture from the taxing angle, and one of the points that I've been trying to address—and I think it's something that we all have been affected by—is this tax-sheltering-type thing.

One area in particular that we're running into a lot of problems with in southern Iowa is, farmers who are being forced to liquidate are subject to this alternative minimum tax. Basically, what it boils down to is, if a farmer is in the process of liquidating and he's using his assets to offset his debts, he is still liable to the IRS.

So I've introduced H.R. 2277 which is designed to exempt those people who are liquidating and over 50 percent of their income is from agriculture being exempt from that minimum tax. That has been incorporated into H.R. 2425, which is the first attempt that I've seen trying to restructure this tax situation.

I'm sure we're probably going to have some people unhappy with that, but at least it's a point to start the debate, and I hope the committee would consider both of those bills.

I think we have been severely affected by the Nation's tax policy at both the State and the national levels. In fact, it bothers me just a little that the Governors now are all pointing their fingers at us and saying, "It's all your fault." I haven't seen any of them back off from any Federal money which has contributed to the deficit.

When you look at the income taxes and property taxes in Iowa, I think there's enough blame to go around for everyone.

So, Mr. Chairman, I compliment you for having the hearing this morning, and thank you for letting us be a part of it.

[The prepared statement of Mr. Lightfoot follows:]

TESTIMONY OF CONGRESSMAN JIM LIGHTFOOT May 31, 1985

PREPARED FOR THE HOUSE AGRICULTURE SUBCOMMITTEE ON DEPARTMENT OPERATIONS, RESEARCH AND FOREIGN AGRICULTURE

Mr. Chairman, Congressman Evans, I'd like to thank you for giving me the opportunity to appear before your Subcommittee today to discuss the subject of taxation as it affects agriculture.

I am pleased as well that you have called this hearing. The issue of tax policy and its impact upon farming has been a popular one in conversation for the past few years. The current economic problems confronting the agricultural sector make the topic of this hearing especially timely. It's only been recently that people have begun to acknowledge the damage being done. Furthermore, farmers themselves have started to recognize the need for change, even if it means loss of certain tax deductions of credits for them personally.

As a new Member of Congress from a highly rural district, this topic was one of the first to catch my attention. In seeking ways to improve agriculture's economic outlook, the tax code appeared to be one area where concrete action could bring about specific results -- the solutions are not so elusive as the answer to the damage caused by a strong dollar or years of high interest rates.

Thus, upon taking office I began to do a little research on the tax code. The long term profitability of agriculture has been severely affected by our nation's tax policy at both the state and national level, but first I'd like to discuss an urgent problem which came to my attention -- the effect of the "alternative minimum tax" on liquidating farmers.

After frantic phone calls from frustrated farmers, their accountants and their attorneys, I looked into the alternative minimum tax. As I am told, minimum taxes are designed to assure that all taxpayers, both corporate and individuals, pay at least minimal levels of taxes. Minimum taxes reduce the benefits of tax sheltering for high bracket taxpayers. A 20% tax rate is applied to alternative minimum taxable income (generally the adjusted gross income plus tax preference items), of individuals. For corporations, a 15% tax minimum tax is applied to the total of the corporation's tax preference less the greater of $10,000 or its regular income tax.

After a little study, I decided to introduce legislation to exempt liquidating farmers -- who derive at least 50% of their income from farming -- from the alternative minimum tax, so long as their assets are used to retire existing debt.

This measure, H.R. 2277, will achieve two goals. First, the bill will ease some of the immediate burden of farmers faced with going out of business. Secondly, my proposal will mean that high income corporations and individuals who do not derive at least 50% of their gross income from farming will be less likely to shelter income by participating in temporary agricultural investments. This will help relieve the competitive disadvantage bona fide farmers and ranchers now face from the abusive tax sheltering of nonfarm income with farm losses.

While the bill was introduced only a few weeks ago, I've noted considerable interest in the legislation. To date, the bill has nearly two dozen cosponsors, including members of the House Agriculture Committee and the House Appropriation Subcommittee on Agriculture.

Now I'd like to turn to the matter of overall tax reform needed to help agriculture's continued viability. Most people familiar with agriculture now agree that the myriad of deductions and tax credits designed to make farming more profitable may have actually had just the opposite effect. Thus I was pleased to join Congressman Hal Daub of Nebraska, a member of the House Ways and Means Committee, in introducing H.R. 2425, the first comprehensive agricultural tax reform measure proposed.

This bill includes six specific steps designed to restore viability to agriculture for the family farmer. Also included in the Daub bill was the body of my measure H.R. 2277. While H.R. 2425 is bound to meet with some controversy among the various special interests which benefit from tax-loss farming, it is an excellent beginning for debate.

As well, it was reassuring to see Ways and Means Committee Chairman, Congressman Rostenkowski, indicate in a recent letter to me that he believed agricultural tax reform should be reviewed along with any effort by that committee to consider comprehensive tax reform.

Mr. Chairman, I am hopeful that your Subcommittee will consider both H.R. 2277 and H.R. 2425 in your deliberations on taxation and agriculture. Again, let me thank you for holding this hearing, and for allowing me the opportunity to appear before you today.

Mr. **Bedell**. Thank you, Jim.

I understand that the other two attorneys did come.

Mr. **Lightfoot**. We all blew in together.

Mr. **Bedell**. If you want to come forward, Mr. Shepard and Mr. Bibler.

Mr. Bibler, you scared me to death. We are trying to hold our testimony to 5 minutes. I didn't think you were going to cover all this, but I see you've got a lot of forms here.

We'll go ahead and start with you, Mr. Bibler.

STATEMENT OF A. DAVID BIBLER, ATTORNEY, ALGONA, IA, REPRESENTING THE IOWA STATE BAR ASSOCIATION

Mr. **Bibler**. The large outline that I have given to each of the Congressmen—and I will be sending one to Congressman Evans—is an outline that, using the tax forms in the back of it, is not as lengthy as reading material; it's more form oriented. It demonstrates, in terms of tax complexity and filling out tax forms, what the tax practitioner and the farm sectors have been looking at in terms of tax problems.

The essence of our testimony relates to just tax and bankruptcy problems that we're seeing in the farm sector, and I'm going to cover just one of the problems, and then Jim Shepard, an attorney from Allison, IA, is going to cover several other problems.

The Iowa State Bar Association sent to Washington Jim Shepard, Orville Bloethe, and myself, and we had met during the week of approximately April 19 with Congressman Evans, Senator Grassley, and did meet with Ron Pearlman, the Assistant Secretary on Tax Policy for the Department of the Treasury.

The reason we went in was to make Mr. Pearlman aware of the various problems in our farm sector, farm economy, from a taxation standpoint and try to get some legislation possibly or some clarification in various tax-related areas.

The area that I want to address just briefly here is the area of alternative minimum tax. In that area, what we are finding is that we have many farm people in our State and in the Midwest in general who have either acquired land at a very low purchase price cost, which becomes your cost basis for later purposes of calculation of gain on sale, loss on sale.

When that property under financial distress is either forfeited, foreclosed—it really doesn't matter what the scenario—any type of transaction is treated as a sale, and what happens at that point is, we have a low-cost basis in the land with a fair market value substantially above that, which creates a capital gain.

In the Bankruptcy Tax Act of 1980, Congress sought to make sure that we close the loophole in the bankruptcy area, making sure that there was taxation of these particular transactions, but the advent of the alternative minimum tax in 1982 created a problem whereby the unwary cannot plan their tax result with any certainty.

Also, possibly if they are not aware of this particular section, what happens is, they have a substantial tax preference item which results in a substantial tax being paid or being assessed.

To give you a practical problem, let's assume that a farmer acquired some property by purchase or through an estate and has a cost basis of $500 per acre.

Let's then assume that the debt load on that land has been brought up to $3,000 an acre as a result of possibly subsequent mortgages or a number of instances, and let's presume that the fair market value now is approximately $1,500 per acre.

Obviously, if you just treat that piece of land and consider the debt is insolvent, he has an inability to pay his obligations, and what you've got is a situation where most likely his creditors are either going to be trying to forfeit out if it's a contract purchase, or they're going to try to foreclose on that particular piece of property.

The tax result of that is that you have a gain level from $500 to $1,500; you have a $1,000 per acre gain. Let's assume that we had 160 acres of farmland. That's $160,000 worth of capital gain. Only 40 percent of that would be taxed at a regular tax basis measure.

These taxpayers normally have carryover net operating losses, investment tax credit carryovers, or income averaging could be utilized to get rid of that regular tax liability.

But, as a result of the implementation of the alternative minimum tax in 1982, the 60-percent additional portion of that capital gain is a tax preference. It results in alternative minimum tax, which is below the line. There is no vehicle by which to offset that tax liability.

As such, we are seeing many taxpayers in our areas that are having to implement bankruptcy procedures simply to get rid of that tax liability. Even if they do implement bankruptcy procedures, the normal course, which Jim Shepard may address here in a moment, relating to bankruptcy, is that the property is later abandoned back to the debtor under Iowa law and most Midwestern States, with the possible exception—there may be an exception with Minnesota in the way that that is handled in the bankruptcy laws of that particular State.

But the abandonment goes back to the debtor. Thereby, the title passes back to the debtor. The bankruptcy law treats that as a passage of the tax consequences back to the debtor, and even after bankruptcy, if that happens, the debtor is once again responsible for the tax. He is insolvent, he cannot pay it in the first place, he takes bankruptcy, comes back out the back end, and he's still liable for the tax.

So what we are proposing—I've got a shorter version, which we have also handed in in the multiple copies—Congressman Evans had introduced in the last session a bill—have you reintroduced that, Congressman?

Mr. **Evans** of Iowa. Yes.

Mr. **Bibler**. Is it 506?

Mr. **Evans** of Iowa. Yes.

Mr. **Bibler**. OK.

House 506. That bill is designed to correct that, what we feel was not intended in the Internal Revenue Code—a mistake, if you will—because of the 1980 Bankruptcy Tax Act implementation, followed by the alternative minimum tax, with no thought that the alternative minimum tax would apply to insolvency situations.

The bill that Congressman Evans has introduced, and has been introduced in the Senate by Senator Grassley, is a bill that would correct or amend the alternative minimum tax section of the Internal Revenue Code to make the capital gains preference inapplicable in situations where you have an insolvent taxpayer. That would keep the taxpayer from having—the trap for the unwary would be resolved, and the problem coming out the back end of the bankruptcy would be resolved.

One thing that I did not give to you, which you might take a look at just in reference, with regard to possible legislation in this area, is senate file 24 in Iowa, which has been sent to the Governor for signature. As of yesterday morning, it had not been signed. I think he has got until June 3, and the indications are that he will sign it.

That particular bill wipes out the alternative minimum tax in Iowa to the extent that a taxpayer is insolvent, and then it goes one more step. It also wipes out the tax on what I refer to as the marginally solvent taxpayer, and that is the taxpayer who has an inability to pay his debts when they come due and, for all intents and purposes, could take bankruptcy but generally still has some marginal level of assets.

In my particular case in our office, we have two examples of that, one which I'll give you.

A farm client had 180 acres of land which he inherited from his father, mortgaged 90 acres of that land with PCA, a very low-cost basis then—I think it was about $600 an acre—was unable to pay the PCA debt, so he sold off 90 acres of the land to cover it.

The result of that sale was $18,000 of alternative minimum tax. The individual right now has a job working at Winnebago. He is a W-2 employee, his wife is not employed, and his top salary is approximately $18,000. Where is he going to get the money?

There are many, many instances.

I'll turn this over to Jim Shepard now.

We do have a survey which we'll review with you just at the tail end. It was not included in our submission of written materials but will be added as additional materials shortly after this.

It indicates a response from 60 attorneys in Iowa at a spring tax institute seminar in early May. That will indicate the level of magnitude of these problems.

[The prepared statement of Mr. Bibler appears at the conclusion of the hearing.]

Mr. BEDELL. Mr. Shepard, we are going to have to watch our time. We have tried to hold everybody to 5 minutes, and we have been over a half hour now already with two witnesses. The problem is that we're not going to be able to get all of our witnesses in. So we would ask you to summarize as much as you can.

STATEMENT OF JAMES I. SHEPARD, ATTORNEY, ALLISON, IA, REPRESENTING THE IOWA STATE BAR ASSOCIATION

Mr. SHEPARD. I will be brief. My comments are summarized in the letter under the letterhead of the Taxation Committee of the Iowa Bar Association. I just want to briefly point out comments in regard to points 2, 3, and 4.

Mr. Bibler spoke of the problem of the farmer who purchased land that cost him $500 an acre. At one point, he borrowed $3,000 an acre against the land, and the fair market value was $1,500.

We have a problem if the land is transferred to the lending institution in satisfaction of the debt or if there is a foreclosure or forfeiture.

Speaking of point 2 in our letter to Mr. Pearlman, in this situation there is a Supreme Court decision known as Tufts, which came down in 1983, which stated that you treat the full amount of the debt as if it were cash paid for the land, so that you would have gain based on the excess of the debt over the cost basis for $2,500 of gain.

At the same time, the Internal Revenue Service, through Treasury regulations, has regulations that say that if there is any discharge of indebtedness which might be excluded from income, that you do not treat that portion of the amount realized as amount realized for determining gain.

In other words, anything over fair market value up to the limit of the debt would not be gain, and it might be excluded.

The problem we have is, under Tufts, there is a great deal of confusion which has arisen as to when you will have a discharge event which might be excluded. We're left, not knowing for certain.

I have presented some continuing legal education seminars and have told the people attending to compute it, do it both ways, and do what seems best, because we don't know.

I think it would take legislation to correct the problem and to clarify the issue. It is possible it could be done with Treasury regulations, but I don't believe so, in light of the fact that we have the Supreme Court decision that quite clearly indicates otherwise.

The second point that Mr. Bibler previously touched on is that we have a problem with the trustee abandoning property. Trustees commonly abandon property under the Bankruptcy Code that is a burden on the estate or of inconsequential value.

What this amounts to is, if the debtor has no equity in the property, such as the farm land, where the debt is in excess of the fair market value, it's abandoned, it goes back to the debtor, and that's where the foreclosure takes place, and that's where the burden lies, in the debtor's hands.

However, if they could put together some kind of an arrangement so that the land is transferred from the trustee in bankruptcy to the lending institution in satisfaction of the debt—in other words, the same transaction—then the tax consequences are trapped in the bankruptcy estate, and the debtor does not have the burden.

What is happening is that we're trying to work with the trustees to create what seems to be somewhat of a sham transaction, just to avoid the tax consequences in the debtor.

What we are saying in our letter to Mr. Pearlman is that there should be no difference whether the transfer is after abandonment or before abandonment as long as it's in satisfaction of the same debt.

The third point is that we have the Bankruptcy Tax Act requiring the trustee in bankruptcy to file tax returns and do various things. However, there is Federal law—it is cited in point 4 of the letter to Mr. Pearlman—which says that the trustees in bankruptcy have no personal liability for any of the taxes incurred by the estate.

Consequently, trustees, not being tax lawyers but bankruptcy lawyers, treat the matter in a rather cavalier manner, and on rare occasions do they file tax returns.

Consequently, the debtor, who eventually has to assume the remaining tax attributes and has to deal with and understand the tax consequences of the bankruptcy estate, is left not knowing what happened.

There is no requirement in Federal law in the Bankruptcy Code or Internal Revenue Code which requires the trustee to make any form of a report or notification to the debtor of any significant tax events or the tax consequences, so that the debtor, in trying to compute his own taxes, in relying on the left over attributes or whatever comes back, is left to guess and do his own computation.

Those are the four points that we were talking about. David would like to review the survey we took.

[The Iowa State Bar Association letter appears at the conclusion of the hearing.]

Mr. BEDELL. Is the survey in your information?

Mr. BIBLER. Not right now. We just received that this morning, Congressman. If we can get it Xeroxed here, we will give it to you today.

[The survey follows:]

TOTALS

SURVEY

In order to convey to the Department of Treasury of the United States, also Senator Grassley and Representative Cooper Evans, the existence of income tax problems (either ordinary or alternative minimum tax) as a result of discharge of indebtedness, so that legislative relief might be forthcoming, we would ask that you complete, during the Spring Tax Institute, the following questionaire:

1. How many instances have you been involved with within the past year concerning forfeiture of land contracts? 495
2. How many such contracts have actually been forefeited 325
3. How many such contracts resulted in foreclosure suits 34
4. How many such contracts were continued after adjusted of Principal 88, Interest 62
5. How many instances did you have that resulted in alternative minimum tax 155
6. How many bankruptcy cases did you handle within the past year or refer to others to be processed by them 542
7. How many instances do you know of where there was Bankruptcy and then the trustee in bankruptcy abandoned the property back to the debtor with resulting forfeiture or foreclosure then taking place 480
8. In the bankruptcy cases, how many completed tax returns 25

   4.5%

   In such cases how many times was the shorty FY elected 4

(sign)__________

(address) __________

(Telephone #) __________

____

Total Responses: 60 ~~[illegible]~~

Mr. **Bibler**. There are two points that I want to make.

Jim just mentioned noncompletion of tax returns in bankruptcy by bankruptcy trustees. In this particular response, we had 60 responses, as I said, from attorneys from Iowa with the spring tax institute held in Iowa City the first weekend in May.

Question 6 of this survey was, "How many bankruptcy cases did you handle within the past year or refer to others to be processed by them?" "Five hundred and forty-two cases."

Question 8: "In the bankruptcy cases, how many completed tax returns?" "Twenty-five." Their requests, 4.5 percent, and that's it. It's a major problem.

Question 7: "How many instances do you know of where there was a bankruptcy and then the trustee in bankruptcy abandoned the property back to the debtor with resulting forfeiture or foreclosure then taking place?" "Title passes back to the debtor. The tax consequence is at the debtor level. Four hundred and eighty instances."

Question 5: "In how many instances did you have the result of an alternative minimum tax?" "One hundred and fifty-five instances," from 60 responses.

Are there any questions?

Mr. **Bedell**. Mr. Evans?

Mr. **Evans** of Iowa. Thank you, Mr. Chairman.

I want to compliment Mr. Bibler and Mr. Shepard for a great deal of hard and detailed work that they have done on these problems in the last few months.

I specifically want to thank them for coming to Washington and visiting with Assistant Secretary Pearlman, who is the Assistant Secretary of Treasury for Tax Policy.

I know for a fact that your visit with the Assistant Secretary dramatically changed his attitude toward the problems of taxation and agriculture, and I just wonder how much of it ended up in Treasury II. I'm not certain yet, but I would hope that a significant part of it has done that.

If I may, Mr. Chairman, I don't know to what extent the letter from Mr. Shepard to Assistant Secretary Pearlman has at this point been made a part of the record, but I think it contains some very excellent material and should be.

Mr. **Bedell**. Without objection, all of this material will be entered in the record or held in the committee files.

Mr. **Evans** of Iowa. I have one question of Mr. Bibler.

Talking about the alternative minimum tax, to what extent would indexing the basis, which has been proposed, eliminate this problem? I'm under the impression that, in Treasury II, indexing the basis of property so that it increases over time in accordance with the inflation rate in the country is one of the provisions in that proposal.

It would seem to me that that would, to a large extent, overcome the problem of the alternative minimum tax. Would you agree or not?

Mr. **Bibler**. I think it could. Indexing the value of land could overcome the problem of alternative minimum tax. However, I go back to the indexing of the land. I think it's completely unworkable.

I go back to the carryover basis that didn't work in 1976. I think it's going to be the same problem. You do not have the accountants available out there to do those calculations. I can't see how it's workable.

Mr. **Evans** of Iowa. Yes. To just comment on this, the fundamental issue here is the issue of what indexing procedure you use. Do you index it by land-value increase indexes or general price indexes? If using the general price index, then you may not succeed in eliminating all the impact that you were wanting to with an indexing system because land-value indexes are different from general price indexes.

Mr. **Bedell**. Would the gentleman yield on that?

Mr. **Evans** of Iowa. Yes, be glad to yield.

Mr. **Bedell**. It seems to me it would be fairly simple if you actually have a table to show that if you index it according to inflation, you could show that if, for example, it was 5 years old, this is the difference.

Mr. **Boehlje**. That is right.

Mr. **Bedell**. It would not be complex.

Mr. **Boehlje**. No, the mechanical part of that, with respect to the computations, is not difficult. What I am saying is that if the index doesn't match what really happen, if you use a general price inflation index, but land-value went up by something significantly different from that, then you would have part of that value increase that is not indexed or not detected. So you still have the problem.

Mr. **Bedell**. OK, sure.

Mr. **Shepard**. I think there is a problem if you index the cost and tie it to inflation because what we have experienced, the problem is being caused by disinflation so that you would, in fact, have a reduced cost back to where we are having a problem because the debt load is still high. The gain we are experiencing producing the alternative minimum tax is between the debt load and the cost basis so your cost basis will fluctuate with inflation and because of the disinflation in the value of land, you would be back to where we are.

Mr. **Evans** of Iowa. My understanding is—and I could be wrong—I don't think any of us know for sure what Treasury II is all about, but it is my understanding that the basis would be indexed according to inflation in the general economy and not land value. I would just submit that for somebody that bought land for $500 an acre a number of years ago, the increase in the general inflation of the economy would have brought that basis up to the $1,500 that you were talking about.

Now, I may be wrong, and I am sure that we don't have time to belabor that today. Just one short question, Mr. Boehlje.

Do you think that doing away with the tax breaks to offset nonfarm income would substantially return the numbers of cattle to the farm in Iowa, as opposed to keeping them in the feedlot? Would there be a beneficial effect that way in your judgment?

Mr. **Boehlje**. I think that it would have some impact, but that is not the determining or sole determining factor at the location of that industry in my judgment. It would have—we would have a more equitable set of incentives now or opportunities for that industry here in Iowa, but we have to also worry about the location of the packing industry and those types of issues as well.

It certainly would help, but I would not expect us to be able to say we would see a dramatic growth because of that singular change.

Mr. Evans of Iowa. Thank you, Mr. Chairman.

Mr. Bedell. Thank you, Mr. Evans.

Mr. Penny.

Mr. Penny. I have no questions right now.

Mr. Bedell. Mr. Lightfoot.

Mr. Lightfoot. No questions.

Mr. Bibler. Mr. Chairman, may I make one more comment?

I notice Congressman Lightfoot has also introduced a bill—I believe it is H.R. 2277 in the House—and we don't need to really debate it now, but I think it is somewhat at odds with the bills introduced by Senator Grassley and Congressman Evans, and I guess the Iowa State Bar position is that we would like to see all the Congressmen in Iowa work as a team on this particular bill.

I think there are some good aspects possibly in Congressman Lightfoot's bill, but our indication was from Mr. Pearlman that any reference made to the farm sector, per se, would probably not be looked upon favorably by either the House or the Senate.

That may have changed in Washington recently, but that was our impression and generally we would like to try to get a consensus if we could.

Mr. Bedell. Well, if I might, I think the purpose when we introduce some of these bills is to generate some ideas for discussion purposes. I don't think it is a question of them fighting each other about what is going to be in the bills.

Mr. Bibler. No, I didn't mean that. Both bills are helpful. It is just that they are somewhat at odds right now.

Mr. Bedell. OK. We thank you very much for your testimony.

Our next panel consists of David Williams, of Villisca, an Iowa farmer, president of Iowa Farmers for Tax Reform; and Paul Linder, of Hartley, Iowa farmer and cattle feeder.

We have a problem which is not unique to these hearings in that we allowed ourselves 2½ hours for the total hearing with four panels and our first panel took nearly an hour. I don't want to be difficult, but if we are going to let everybody be heard, and some people have come a long way, we are going to have to be, I am afraid, much more strict in trying to hold you folks to your 5-minute limitation.

We also have a representative here from Senator Grassley's office. Does Senator Harkin have a representative here?

[No response.]

Mr. Bedell. OK.

We will hear from you first, Mr. Willey, representing Senator Grassley.

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA, PRESENTED BY WYTHE WILLEY, STAFF

Mr. Willey. Thank you, Mr. Chairman, Congressmen.

Senator Grassley appreciates the opportunity to participate in this hearing this morning and he offers to you his assistance as a member of the Senate Finance Committee, which is, of course, the principal tax-writing committee in the Senate. Senator Grassley is speaking in Des Moines this morning, so he asked me to come up here and present his statement.

Also present is Julie Rabinowitz, who is the Senator's staff person for the Finance Committee and works primarily on tax matters, so if you have any particular questions, you might want to talk to her about that.

I have a statement from the Senator to file, but let me quickly mention just a few of the things that are of importance.

Mr. **Bedell**. The entire statement will be entered in the record.

Mr. **Willey**. Thank you.

Let me mention a few of the things that have happened on the Senate side of the aisle on these issues.

In his capacity as a member of the Senate Finance Committee, Senator Grassley has made it his first priority to bring to the attention of the Senate the often negative effects of the Tax Code on the ag sector of the economy. Last year, he worked to pass a number of provisions in the Senate which would have benefitted our farm economy.

The first was a bill providing soil and water conservation credits. In order to raise the revenue to offset a revenue loss attributable to those credits, a provision was included which would require an extension of the depreciable life of single-purpose agricultural structures. This legislation has been reintroduced this session.

While this measure passed the Senate, it was later dropped by the Senate-House conference committee. The Senator would be pleased if other members of the Iowa delegation would work on similar legislation in the House which, if passed by both Houses, would have a better chance of final passage by Congress.

Last year, Senator Grassley attempted to amend the 1984 Tax Deficit Reduction Act with a provision which would have eliminated the capital gains as a tax preference item for individuals selling property in drought-affected areas. He has reintroduced similar legislation early this session which would eliminate capital gains as a tax-preference item in the case of a forced sale by an insolvent taxpayer.

Congressman Evans and he have worked closely with the Assistant Secretary of the Treasury, Mr. Pearlman, and members of the Iowa Bar Association—some of whom are here giving testimony this morning—to bring about the administrative relief in this area by regulation, and to craft the appropriate legislation to address the problem facing many farmers. We are confident that a continued and concerted effort in both the House and Senate can result in a solution to this inequity.

The alternative minimum tax provisions were never intended to result in tax liability in this situation. Considering the alternative minimum tax provisions contained in the President's recently released proposal, we must all work to ensure that no tax plan is passed which fails to solve this critical tax problem, particularly for farmers being forced to liquidate their assets.

I might refer to those bills. That is House 406 from Mr. Evans and Grassley's Senate 418, which has been referred to.

Let me also mention very quickly that some steps have been taken to enact legislation which eliminates some of the tax advantages for investors in cattle-feeding tax shelters and at this point, I would like to acknowledge the cooperation of the Iowa Cattlemen's Association, which has worked very closely with our office on this issue. I know they will be presenting testimony later, but they have been very helpful to our office in these matters.

During the Finance Committee's consideration of the deficit reduction package, the Treasury Department recommended the elimination of any prepaid expenses before economic performance occurred. Some of the committee members objected to this approach to stop the mismatch of income and expense. Valid business reasons do exist for prepayment. In agriculture, smart farmers and ranchers buy fertilizers, seed and feed in the fall when the prices are lower. It is a good and accepted business practice which helps farmers reduce the cost of production at a time when it is very difficult to earn a profit.

After discussion, Treasury did acknowledge the valid business purpose of paying expenses in agriculture ahead of the year in which economic performance occurs, but did express concern that wealthy investors seeking to reduce their tax liability at year end were investing in cattle tax shelters which used prepaid expenses to obtain as much as an $8 deduction for each dollar invested.

According to Iowa cattlemen, the presence of tax shelter investors has caused problems to the industry in this State. Traditional cattlemen without tax-shelter cattle were having difficulty competing against cattlemen whose customers were not motivated by profit and who had a source of capital for which they didn't have to pay a market rate of interest. Compared to our cattlemen, it simply was an unfair advantage, in addition to causing problems in terms of the time when the cattle would come to market.

To address this problem without losing the legitimate prepaid expense provision, Senator Grassley crafted a rule to limit prepaid expenses to 50 percent of an individual's farming expenses during the taxable year. Farm expense would include most normal operating expenses of the farm, including those trade and business expenses claimed under section 162.

We really think that, while this provision did not pass in its entirety, that some of the tax shelter provisions that were passed in the 1984 act, particularly some of the review that IRS is able to give tax shelters, the registration of tax shelters, might go a long way in helping hold down this problem, and certainly should help some of the bona fide farmers and cattle feeders who were at a severe disadvantage in this area.

In the interest of time, I will open it up to any questions you might have and once again, we will offer our assistance to you on the Senate side for whatever your committee might want an input.

[The prepared statement of Senator Grassley appears at the conclusion of the hearing.]

Mr. BEDELL. Thank you.

Mr. Williams.

STATEMENT OF DAVID L. WILLIAMS, FARMER, VILLISCA, IA

Mr. WILLIAMS. Mr. Chairman, I am a working farmer. I put this paper together myself without a staff. I am not an attorney, professor or politician and my time limit will be within the 5 minutes.

It seems to me that with the extreme economic problems facing rural agriculture, one of the most obvious items we should address is tax policies. My son, Bruce, and I operate a diversified livestock and grain farm. We raise corn, soybeans and alfalfa, have a farrow-to-finish hog operation and a cow-calf program.

The cattle feeding industry in Iowa has been reduced by 40 percent in the last 4 years. Many of the large cattle feedlots are financed by outside investor money. The cattle breeding herds of both dairy and beef have also been fueled for years by outside investors. In recent years, with the advantage of tax policies, we are seeing large hog operations financed by nonfarm investors.

In the 1960's and 1970's, with inflation of land, low interest and good returns on livestock and grain operations, farmers took advantage of investment credit, cash accounting, capital gains and accelerated depreciation. I see that in the tax information that the President put out, they are diluting that, cutting it down. It has been recommended it be to 15 years and I guess it was 5, and they are talking 8. I think that should be spread out.

With good returns from our farming operations, we were able to utilize these tax policies to reduce our taxes and expand our farming operations. I have been confident for some time that the good efficient hog producer raising his own feed could compete with anyone. With lower margins, higher real interest and increased production of all commodities, it has been increasingly difficult to get a dollar return to survive.

Large corporations with access to high tax bracket money are not necessarily driven by profit. The difficult times in the swine industry have introduced contract feeding of hogs. Producers having trouble getting financing are providing their own labor and facilities to finish hogs for corporations or wealthy investors.

Personally, I don't fear competition from a fellow farmer in our swine operation, but I do fear tax shelter money raising hogs for a low return and/or later to establish a monopoly position. Tax advantages have made the hog industry attractive to nonfamily farm corporations in spite of the fact that hog farmers have lost money in 4 of the last 5 years. Thirty percent of the Nation's hog producers were lost from 1980 to 1982. This is a key point. Yet six nonfamily farm corporations have found it to their benefit to undertake or announce major expansions which will add over 1 million hogs per year to the market.

I have commented on tax shelters as they have affected swine operations because the production of swine is the major enterprise on our farm.

I would like to comment briefly on some other thoughts. Does it make sense to bring into production with Government money more land to raise more grain when we already have a surplus?

For example, the Interior Department is going ahead with an irrigation project—this is the Garrison Dam project—in North Dakota that will irrigate 408 farms at a cost of $1.6 million to each farm. The irrigation costs to be repaid by farmers without interest translates into an additional $600 million subsidy.

The Federal Dairy Program guarantees that the Government will buy all the milk a farmer cannot sell—more than $6 billion in the last 3 years, yet Federal tax laws help stimulate overproduction by allowing investors, to buy cows, write off much of the investment, and avoid taxation on other income.

The abuse of land—and this is very dear to my heart—hundreds of thousands of acres of fragile rangeland in the West have been plowed under since 1978 and converted to the production of wheat, which is the country's major surplus crop. The double dip of tax writeoffs, along with Federal crop subsidies, has cut Treasury income, increased farm program costs, intensified soil erosion problems and depressed farm prices.

Another example is the intensive farming in the Sandhills of Nebraska by outside investors. All the tax shelter advantages are used, including the conservation tax credits and the depletion allowance for pumping irrigation water from the Ogallala aquifer. The PIK Program of just 2 years ago was very much used by this group in the Sandhills.

We realize that the tax shelter problem is not isolated to the Midwest, but has created economic disaster for the small fruit and vegetable farmers, the small timber industry and others in productive agriculture.

I am involved with an Iowa grassroots committee studying the impact of current tax policies on agriculture. We are planning a unique working seminar in July that will provide more information on this problem. We intend to invite all of our Congressmen from Iowa and their tax aides to this meeting.

Harold Briemeyer, a noted economist at the University of Missouri, made this statement in testifying before a congressional committee: "Let's be honest, there is no chance of preserving family farming if tax rules are not changed. There's no point in even trying unless the tax matter is addressed and corrected."

I appreciate the opportunity to be a part of this committee hearing and applaud Congressmen Bedell and Evans for addressing this very important issue. I welcome questions.

Mr. **Bedell**. Thank you, Mr. Williams.

Mr. Linder.

STATEMENT OF PAUL A. LINDER, FARMER, HARTLEY, IA

Mr. **Linder**. In order to move things along, I would just like to summarize some of the things that are in print here.

I have been on a farm for 61 years so it is nothing new to me. My main enterprise is feeding beef cows and we have about a capacity of 800 head. I do farm about 640 acres, so I consider myself nowadays one of the endangered species.

I have lived on this farm all my life except for about 2½ years in the service and 4 years at Iowa State and also I used to work for industry for 3½ years.

We farmers live in a very competitive world and I am in favor of that, but I feel that the competition should be fair. I do not believe that the kind of competition in the beef industry is fair. We find ourselves at a place where we are striving just to exist.

When I first made use of investment credits, it seemed like a good idea. However, I began to question its impact about 8 years ago. I have designed feedlots throughout the United States as a part of my—when I was with industry and also as a private person, and I soon became aware of the influence that investment credit had on expansion.

I also became a victim of that myself. When income is good, spending money reduces taxes. I quickly went through my tax returns for the last 5, 6, 7 years, I guess, and it is in my prepared statement.

What I want to bring out mainly is how my income has varied and I have done as much as I could to try to keep it uniform. Also, when my income was up, you will see where investment credit is up. In the last 3 years, you will see that investment credit has not been used, so I think it kind of speaks for itself.

Our tax system encourages people with high incomes to use this tax break. The expansion of cattle feeding facilities, especially in Texas and Kansas, would not have occurred nearly so quickly had there been a limit of possibly $5,000 for agriculture investment credit.

Investment tax credit becomes abused when investors can sell and reorganize and take the credit again. I wonder how many times this scheme has been used in some of the facilities?

Capital gains are also working against low- and middle-income farmers. These taxes are for the benefit of those who are in the high tax brackets. I personally know of a wealthy person whose main income was other than agriculture and he purchased heifers and had them bred and sold them later so he could use capital gains. I know this wasn't an economical thing as far as feeding operations, but it was for a tax purpose. The person even told me this.

I dislike being suspicious, but I question the wisdom of having only a period of 6 months for qualifying capital gains. This is an advantage to me, as I see it, for the speculator. When one purchases something and sells it within 6 months, I call it speculation.

I also question capital gains treatment for stocks. It seems to me that this could be used as a tax shelter or loophole for corporate livestock operations because they could use it, then, for capital gains.

We know of some very influential and wealthy people who have had buyers purchase cattle for them and place them in commercial lots. One order was supposed to have been for 90,000 head. Such an order greatly increases the price of the feeder cattle at that period and they were placed into a lot not too many miles from home with a stipulation that they not lose over $120 a head.

This I cannot understand, but I certainly can see how deferring tax could be to their advantage.

Custom hog feeding has become quite popular in my area during the last 2 years. There appears that there is a tax advantage to wealthy investors when a 220-pound hog, ready for market in November, is held over until the next year for tax purposes. This is not economically practical for efficient livestock operation. This tax incentive creates excess pounds of overfat meat for the marketplace, and thus depresses the prices.

One has to have much faith in the future to be a farmer. We have dreamed of building a unit which we thought could support two families. We raise most of our feed for the cattle and attempt to be as efficient as possible. We are not afraid of work. Our dream of the future, of our farming operation—especially the livestock—is shattered by unfair use of capital gains and investment credit, by people whose only objective is in reducing their income tax.

I again wish to thank you for your interest in the tax laws and their effect on the farmer. I would like to leave you with this question: Should the farming business and the livestock business be forced into a situation where it can only exist with external subsidization or should it be allowed to exist in an environment of fair competition and equal opportunity?

[The prepared statement of Mr. Linder appears at the conclusion of the hearing.]

Mr. **Bedell**. Thank you very much.

Mr. Evans.

Mr. **Evans** of Iowa. Thank you, Mr. Chairman.

I would like to pursue one point that you raised, Mr. Linder, about the capital gains. It is my understanding that in Treasury II, capital gains treatment of sale of a lot of livestock has been eliminated. I may be wrong about that, but I think that is generally true.

I am curious about your comment on stock and capital gains. Now, if I understood you correctly, your fear is that one could take a group of cattle and make those cattle the only asset in a corporation, for example?

Mr. **Linder**. You have to be incorporated.

Mr. **Evans** of Iowa. The only asset in the corporation is the cattle and then, even though there were no capital gains available on the cattle themselves, there could be on the stock in the corporation; is that right?

Mr. **Linder**. That is my understanding. I really question it.

Mr. **Evans** of Iowa. That is a very good point and one that I hadn't heard raised before.

Mr. **Bedell**. Would the gentleman yield?

Mr. **Evans** of Iowa. Yes, be glad to.

Mr. **Bedell**. If we index, if we were to index the valuation, why would we need to have capital gains? The purpose of capital gains is to take care of inflation, as I understand it. If we did index it, couldn't we eliminate capital gains?

Mr. **Evans** of Iowa. You probably could on some things that are in agriculture. I don't know that that would apply to stocks, for example.

Mr. **Bedell**. But wouldn't it apply because you would have regular income on any appreciation that was greater than inflation?

Mr. **Evans** of Iowa. That is a possibility. I don't think any of us know enough about what is in that huge package right now to speak with any authority on that.

One question for both Mr. Williams and Mr. Linder. If we were to change the tax laws on cattle feeding, in particular, and greatly limit the extent to which those losses could be used to offset other nonfarm income, do you think it would have a major effect on getting cattle back on the farm and back into the State of Iowa?

Mr. **Williams**. I know the hog situation better than cattle. I think the hog industry has seen some very large, large operations. One farm is raising 1 percent of the hogs in America and has sold the breeding herd to go out after more tax shelter money and I think if you change the tax policy, we would see that kind of money scurry away real fast.

Mr. **Evans** of Iowa. And the hogs come back onto the smaller farms.

Mr. **Williams**. I feel that way. I don't fear that competition if they are ever on a level field with us.

Mr. **Evans** of Iowa. Yes.

Mr. **Linder**. I wouldn't say it would be a major factor. I can see where maybe I can exist longer. I don't know if we had a lot more people come in—I mean, or the people who have been out come back, because we have to have a profit in it. Without profit, if I am not subsidized, I can't continue on.

Mr. **Evans** of Iowa. Yes.

Thank you, Mr. Chairman.

Mr. **Bedell**. Mr. Penny.

Mr. **Penny**. Mr. Williams, we have heard recently about the possibility of investors coming in and acquiring farmland from farmers who are heavily leveraged and then renting it back to those same farmers with an option to buy again the same land that they once owned. Do you want to comment about the attitude that your group might have about that kind of financing arrangement?

Mr. **Williams**. I don't personally know of this happening. I have heard about two situations—one group coming down from Nebraska to buy some southern Iowa land and another group—I think from the Des Moines area—that has come into south-central Iowa. I think this could very well happen. What they are doing is they are using soil and water conservation law and pushing out the buildings and the fencerow and I guess I am concerned for two reasons, that farm being lost to a large investor and I see it as a soil and water conservation law that they are able to expense really tremendous erosion, you know, so I think that alone is a real concern of mine.

Mr. **Penny**. There is some talk of that land being rented back, though, to the previous owner and I guess I have some concerns about that development. I am not positive that if someone else owns the property and rents it to you with an option to buy that that opportunity to buy is ever going to materialize.

I thought that since this has been a proposal put forward in the light of so many farm failures, that your organization might have taken some kind of a position on that financing arrangement.

Mr. **Williams**. I think that is going to have to be addressed because FmHA is going to end up with a tremendous amount of land. In fact, they are renting it out now and how that is handled is going to be a unique situation. That is going to happen very rapidly in this year and next year—both.

Mr. **Bedell**. To what extent has some of this nonfarm investment in livestock occurred in Iowa and to what extent is it happening elsewhere in the Nation? In Minnesota, it may be happening through the back door, but anytime we can identify a direct investment, that is against State law and we don't allow that to take place. I am just curious if you know of examples in Iowa where there is a direct investment that has occurred.

Mr. WILLIAMS. Very little that I know about direct investment. I think what is happening is this contract feeding of hogs, which is—Iowa is probably the hottest place in the country on that and is reaching out to the other States.

For the big hog farming operations that are in the South—I mention one, Dyson Farms that has the large operation in the controversial Sandhills area. They came in there with massive amounts of money. That deal was made, incidentally, over the phone by one of the Bass brothers to do this in just a matter of time. Something like $75 million was the initial seed money.

Mr. PENNY. Thank you, Mr. Chairman.

Mr. BEDELL. Mr. Lightfoot.

Mr. LIGHTFOOT. Mr. Williams, you, in your testimony, alluded to the conservation problem, particularly in Nebraska and that area, which I think we all see as probably the landmark of abuse. We have had similar problems in southern Iowa, which I think goes back to our tax problem in the demise of the cattle industry. A lot of those people were very desperate just to try to stay on the land. They tried a lot of things to keep some income and created a lot of conservation problems.

How can we address this conservation thing through tax reform? We have rewarded people for doing some things in some areas. Do you have a clearcut idea on how that should be approached?

Mr. WILLIAMS. It is a pretty complex question. I think the first thing that comes to mind is that I think some of the aspects of the sodbuster bill, the Armstrong bill, is that we really need to—it seems to me we really need to take some land out of production and I think that a lot of that very fragile and highly erodable land is the place to start.

Quite rapidly, we are seeing that the export grain isn't going to be the answer, so rather than putting more fertilizer and fuel and more grain out there, let's take some of that land out of production. I think when we see the Soil Conservation Service Administration try to erode that money, that deeply disturbs me because we are just putting pennies into that compared to the budget.

Somehow or other, we have got to put more emphasis on basic soil conservation.

Mr. LIGHTFOOT. I don't know, you and I have talked about this before, but does really this whole thing boil down to two words: tax shelter? Is that the basic problem?

Mr. WILLIAMS. That is part of it, Jim. We wouldn't see—in our area, we have seen some pretty good-sized operations, quite large operations come in and the first thing they did was take out the fence rows and get rid of the buildings and even take out the terraces—this is sad—and went to a corn-soybean rotation and I have made the statement a number of times in southern Iowa that whenever that land is gone, it will still be there, but it will maybe only grow grass and trees. Maybe that is what it ought to do, but the erosion in my area of the State, southern Iowa, is horrendous. If we could just address the tax shelter part of the soil and water conservation, which is what we are going to do at this—one of the four items we have got to work on at this seminar we are having in July.

Mr. LIGHTFOOT. I agree. I think there is a lot of that country down there that the good Lord designed for cows to walk on anyway and nothing else. That is part of the problem.

Thank you, Mr. Chairman.

Mr. BEDELL. Thank you, Mr. Lightfoot.

Mr. LINDER. I am also very concerned with soil erosion. Up in our area, we are relatively flat. I mean, I don't have any slope over 3 percent. I can drive around the country and see where there was a draw, small draw, and I remember crossing it with a baler and not even notice it is there. You can even see now the tile exposed so you know 2½ to 3 feet are gone. So really, overproduction, if we continue on this way, will be no problem in another 15 years because clay doesn't produce a crop out my way.

Mr. BEDELL. We thank you very much for your testimony.

Our next panel consists of Merlin Plagge, Sheffield farmer representing Iowa Farm Bureau; Richard Steffen, Dunkerton, IA, president of the National Farmers Organization in Iowa; and Russell Lyon, from Toledo, an Iowa farmer and president of Tama County Farmers Union.

We have a statement here from Ken Scott. He had hoped to testify. We are running so late here in trying to get everything done that without objection, your statement will be entered in the record.

[The prepared statement of Mr. Scott appears at the conclusion of the hearing.]

Mr. BEDELL. We will start with you, Mr. Plagge, and we would urge you to hold it to the 5 minutes if you can or we are not going to be able to get everybody on here.

STATEMENT OF MERLIN PLAGGE, MEMBER, BOARD OF DIRECTORS, NORTH CENTRAL DISTRICT, IOWA FARM BUREAU FEDERATION

Mr. PLAGGE. Thank you, Mr. Chairman.

I do farm just east of Sheffield, in Cerro Gordo County, and I represent the Iowa Farm Bureau board in north-central Iowa.

I appreciate this opportunity to speak on behalf of the Farm Bureau on the timely issue of tax reform and the effect the Federal taxing policy has on the family farm.

The current Federal taxing policy has had intended and unintended consequences. In its attempts to aid the family farm, Congress has often established a fiscal and taxing policy which, in the long run, has been counterproductive. Tax policies designed to assist farmers have resulted in overproduction and overinvestment in agriculture by nonfarmer taxpayers cultivating the Internal Revenue Code.

Current tax laws contain many sections of special help and interest to farmers and nonfarmers alike. They include the investment tax credit, the accelerated depreciation and the special tax treatment for capital gains. Many times, we as farmers look only at the individual consequences of tax law, rather than focus on their impact on agriculture as a whole. We in Farm Bureau admit, as must others, that we supported these proposals. Yet they have often come back to haunt us and have led to a never-ending circle of enacting more tax laws to curb abuses.

Farm Bureau supports limiting an individual or corporation from using the investment tax credit or losses incurred in one business from being used as a tax write-off in another unrelated business. We are pleased that bills to limit the amount of nonfarm income that can be sheltered by farm losses have been introduced by Representative Tom Tauke and Senator James Abdnor of South Dakota.

Business and investment decisions should be based upon profitability and not on the tax shelter advantage. We would support a flat rate income tax or a modified flat rate income tax, but only if it is revenue neutral and does not add a new tax burden.

Many of the proposals currently under consideration propose to lower the tax rate. A lower tax rate will reduce the incentive for tax shelter activity in agriculture, as one of the primary causes for tax shelters is a high income tax rate. In conjunction with reducing tax rates, tax reform could eliminate several tax preferences, which make tax shelters work.

These proposals for tax reform must be carefully analyzed. One taxpayer's loophole is or can be another's sole means of support. Many farmers who expanded their livestock operations must now feed cattle or hogs owned by others in order to service the debt incurred to build their facilities. While we criticize the investment farmer, we must recognize that this person may make it possible for many traditional farmers to earn a living.

Farm Bureau has consistently stated, even in this year of the farm bill debate, that a sound fiscal policy will be of greater benefit to agriculture than the enactment of any farm program. Congress must realize that tax policy and the farm program are interrelated and should be complementary. A tax policy which encourages expansion in the agricultural sector will dominate a farm program aimed at limiting production. This is exactly the situation which we find ourselves in today.

Tax reform proposals must be carefully balanced. We must not get into the situation again where Congress enacts a law and then, in order to curb abuses, creates another special law. Two prime examples of this are the alternative minimum tax and the imputed interest rate. Both statutes have honorable purposes, yet farmers without the motivation of tax avoidance, are adversely impacted.

How is one to explain to a farmer who has been forced to sell land to restructure debt, that he has triggered the Federal alternative minimum tax? This farmer pays alternative minimum tax not because of substantial sheltered income, but because of lack of income. Many times the proceeds from the sale are sufficient only to pay off the outstanding debt and maybe sometimes not even that much, leaving no funds to satisfy the resultant tax obligation.

Some years ago, the Iowa Legislature enacted an Iowa minimum tax coupled with the Federal alternative minimum tax in order to tax wealthy individuals who, through the use of tax preference items and tax shelters, avoided paying income tax. On the last day of the 1985 general assembly, a bill was passed which allows an individual with a debt-to-asset ratio exceeding 75 percent, and a year-end net worth of less than $75,000 to exclude the capital gains from a forced sale when determining Iowa minimum taxable income. The bill further provides that a taxpayer's minimum tax obligation cannot exceed the excess of the proceeds resulting from the sale of property after paying back the debts. This legislation is quite complex, as is most tax legislation, and we encourage you to study this proposal to see if it has merit on the Federal level. Regardless of approach, the Federal alternative minimum tax must be addressed to remedy this unintended result.

Regardless of the results, the Federal alternative minimum tax must be addressed [illegible] remedy this unintended result and we understand that several bills have been introduced, including Congressman Lightfoot and Congressman Evans in this area.

Most people now admit that the Tax Code is not designed merely to raise revenue, but also is designed to encourage public conduct in social and economic directions. We believe, however, that any attempts to reform our taxing policy must be judged against three objectives:

First of all, simplicity. The tax laws should be understandable and compliance should be relatively easy;

Equity. Business, individuals and households earning the same level of income should pay the same amount of taxes;

Economic efficiency and neutrality. Business and personal economic decisions should be made for reasons other than tax consequences.

We do appreciate your efforts, Congressmen, and this opportunity to share our views with you. However, we must keep in mind that it is easy to blame outside investors for causing this economic trouble facing farmers. But this blame is misplaced. Who wrote the laws creating the incentives to invest in agriculture? While those with substantial political and economic power helped to guide the enactment of these laws, we must all share this responsibility. We now must be cautious so that the current movement for tax reform does not further injure our weakened agricultural economy.

Thank you.

Mr. **Bedell**. Thank you, Mr. Plagge.

Mr. Steffen.

STATEMENT OF RICHARD STEFFEN, PRESIDENT, IOWA NATIONAL FARMERS ORGANIZATION

Mr. **Steffen**. Thank you, Mr. Chairman. Thank you to Congressmen Penny, Evans, and Lightfoot for their presence here today.

I am a farmer from Dunkerton, IA. I am not a tax expert but I am concerned about taxes. My remarks will be rather brief. I am sure there are others here today that are more expert in the area of taxes than I am. I promise you, Mr. Chairman, to stay within my 5 minutes.

Tax reform is something everyone hopes will come about. Tax reform is something everyone hopes will benefit them. Tax reform is something everyone wants done for them but not to them. Everybody is supporting the idea of tax reform, but the difficult task will be to get that into a piece of legislation that is workable and gets the job done.

It is my belief that farmers are as skeptical of tax reforms as anyone else is. They are as aware of the time and deliberations that their State legislatures and their Members of Congress spend on tax issues as anyone else is. Farmers recognize the difficult task this is for their legislators.

Farmers know that taxes are needed to pay the cost of Government. Farmers know that the cost of Government today is at an all-time high. Farmers know that the taxes they pay, both direct and indirect, are probably at an all-time high.

Farmers would like to see a fairer distribution of the tax burden. The proposal to eliminate the deductibility of State and local taxes will have the effect of increasing the amount of taxes to be paid. Some wealthy individuals are apparently more interested in farming the tax code than in farming the land.

In closing, just a couple of very clear points that should be addressed in tax reform.

One is to reduce to eliminate tax sheltering of nonfarm income with farm losses. This is an unfair advantage to the family farmer. Recently I read where some taxing committee estimated that the sheltering of nonfarm income with farm losses will mean a loss between $2.5 to $3 billion between now and 1987.

Two is correct the inequity which forces liquidating farmers to pay minimum taxes on their holdings.

Three, the special tax provision connected with the single purpose agricultural structures, a provision that has been used in the hog industry. I believe in 4 out of the 5 years since enactment of this provision hog farmers have lost money. Since enactment of this and now something like 25 percent of our Nation's hog producers went under, when at the same time the large mechanized hog producers helped along by the Tax Code, expanded and produced unneeded production which in turn lowered prices.

Four, tax laws that provide incentives to bring marginal land into production should be looked at.

Finally, I want to say that tax reform is not a cure-all for all the problems that farmers face today. Congress needs to look hard at farm tax reform and budget cutting and also at a farm bill that will provide much needed improvement in farm income.

Thank you.

Mr. Bedell. Thank you, Mr. Steffen.

Mr. Lyon.

STATEMENT OF RUSSELL LYON, FARMER, TOLEDO, IA, REPRESENTING THE FARMERS UNION

Mr. Lyon. I am a farmer in Tama County. I represent the Farmers Union.

My comments will be directed to Federal tax policy and some recent development within Production Credit Association.

Farmers Union policies are directed toward the preservation of the family farm. Our tax resolutions, if enacted into law, we believe, will help family farmers to compete with outside investors.

There are various definitions of a family farm, but for my comments we will define a family farm as one where the farmer and his family supply most of the labor and management and the major portion of their income is from sale of agricultural products.

We are all aware of individuals, limited partnerships, corporations or other identities that invest in land and/or livestock to use interest expense, accelerated depreciations, investment credit and capital gains to reduce taxable income from nonagricultural sources. These investments are designed to increase the investors' net worth in addition to the income tax breaks.

We have seen the broiler production become vertically integrated. We have seen large cattle feeding lots develop and a trend toward custom hog feeding. Chicken production has left the family farm. Cattle feeding in Iowa and other Midwest States has decreased dramatically. We see fantastically high prices paid for registered livestock. These things are happening due to tax benefits to those investors who participate.

Farmers Union believes the tax laws should be revised to discourage tax-loss farming. We suggest investment credit tax should be limited to $5,000 total tax credit annually. Investment credit should be allowed only to an individual's primary business. Investment credit should be available in cash transfer of property and equipment between family members on a one-time basis.

Capital gains tax should be graduated by length of time the asset is held. The tax should be 100 percent of the income if the property is held less than 1 year and graduated to 50 percent at the end of 10 years. If such gains are reinvested by the seller in like property within 18 months, there should be no income tax.

We believe an individual should be granted a one-time exemption of $100,000 on gain from real property used in farming or small business.

We suggest farmers liquidated by foreclosure or farmers who deed their farm to a creditor in lieu of foreclosure should not be required to pay capital gains tax. This is extremely important in the current economic condition of the farm sector.

Farm Union does not favor the so-called flat-rate income tax as we feel the high income individual gains much more than does the average person.

Further, we feel the imputed interest rate should be reinstated to 7 percent to allow retiring farmers to sell to beginning farmers at an interest rate that the young farmer can afford to pay.

Now a comment regarding Production Credit Association. My son and I operate a partnership producing corn and beans and finish out feeder pigs. We have been PCA borrowers for the past 10 years.

On Monday, May 13, three Iowa PCA Associations froze their stock. Six more took this action on May 29. A news story on Wednesday, May 28, stated that PCA and Federal Land Bank Association interest rates will be going up.

For those not familiar with PCA procedure, let me explain. PCA's are a cooperative. When a farmer borrows money, he also must purchase stock equal to 10 percent of the amount borrowed. To borrow $9,000 operating money, we actually borrow $10,000 and pay interest on that amount. The $1,000 worth of stock stays with the lender. Normally, the stock investment is increased as the loan balance is increased or decreased as loan balance is paid back. When the stock is frozen, a farmer's stock investment cannot decrease as the loan balance goes down. However, if the loan principal is increased, additional stock is purchased and the freeze is applied at the higher figure.

A farmer who may want to change lenders will have to buy his stock in addition to paying back the total loan principal in order to have the lien on his assets released. In other words, it will cost 10 percent more since the freeze than before.

In our personal case, we signed loan documents for an FmHA loan on May 13th and attempted to pay off PCA on the 14th and learned that we had to buy $8,800 of stock to obtain a release of assets so FmHA would have first lien. Through contact with out local PCA board member, we learned on the 15th that our assets would be released to FmHA but the $8,800 of stock would remain on note and interest charged.

Current interest rates at our PCA are higher than most other lending agencies, 0.1505 percent for most borrowers. Federal Land Bank interest at our Marshalltown Association is 0.1275 comparable with other lenders, I believe. Increased interest rates we farmers do not need.

I understand that Representative Evans has introduced a bill to inject more capital into the Farm Credit System. This is surely needed, and I would urge quick passage of that bill.

Thank you.

Mr. BEDELL. Thank you, Mr. Lyon.

Mr. Evans.

Mr. EVANS of Iowa. I have a general comment. It is nice to see you three gentlemen from three different organizations sitting there together today. While there are some differences of opinion among you, I think the general agreement among you on the approach to tax policy is notable. I compliment you on that.

Thank you very much for coming.

Mr. BEDELL. Thank you.

Mr. Penny.

Mr. PENNY. I would like to ask each of you not for names but for numbers or a rough guess on numbers of neighbors of yours that have been affected by this capital gains tax situation within the last year or two. You must know of some examples. Can you give me a rough estimate?

Mr. PLAGGE. I wouldn't want to give you any estimates. But in just thinking of our particular area of the assets that are being liquidated, there has to be quite a tremendous impact there. We have had several in our area who are needing to liquidate. Without a doubt, this alternative minimum tax is going to affect them very, very greatly.

Mr. PENNY. For my benefit as I am from southern Minnesota and not familiar with your area.

Mr. PLAGGE. Sheffield is just about 20 miles south of here.

Mr. STEFFEN. I am not aware of a great number in my immediate neighborhood. I know that there are a number within my county. As far as giving you a number figure, it would be strictly a wild guess on that. However, the association that I have across the State appears to be a much greater number, for example, in southern Iowa than where I am, in northeast——

Mr. **Penny**. The county is what again?

Mr. **Steffen**. Black Hawk County.

Mr. **Penny**. Based on the economic circumstances facing a number of people in your county, is it safe to assume that this capital gains tax is clipping some folks in your immediate area?

Mr. **Steffen**. Yes.

Mr. **Penny**. But through your association you indicate that in south Iowa the problem is more extreme.

Mr. **Steffen**. That is right.

Mr. **Penny**. Mr. Lyon.

Mr. **Lyon**. I am located in central Iowa. In fact, it would be just south of Black Hawk. We are not in one of the more depressed areas probably. I would not be able to give you a percentage. I do know that there have been many meetings and much concern among people in the county in this regard. And from a personal standpoint this has been really vital to me in that I have problems with real estate loans. For the past 2 years I have studied selling the land, what impact the tax would have on me. In fact, I have sold some land. Fortunately, I guess, I had enough loss in the last 5 years that it hasn't cost me much. But down the road, I am worried about it. I am trying to get in a position to protect myself from that.

I think that we don't know some of our neighbors are in that situation until 2 years after it's too late. Our pride gets in the way, as the fellow says.

Mr. **Penny**. I appreciate your responses. I know it is probably difficult to come up with a number. But the main thing I was trying to get at is that each of you is aware that it is happening in your own area, even if yours is one of those counties that isn't as hard hit as others.

One of the difficulties we have is persuading our colleagues that the problem is real. One question they always say: well, give us some examples and let us know that it is really happening, that it isn't just something that is fabricated out there.

Mr. **Lyon**. If they need an example, I will be glad to give them one.

Mr. **Penny**. And we want to be able to go back and tell them that we are hearing about this kind of a problem in every county across the State and that it is not something that is just isolated in certain areas, it is a widespread problem throughout the entire farm belt.

Mr. **Plagge**. Congressman, one other comment I might make on that very area. Many times, the actions that people need to take to try to avert some of these things that are created by some of these laws get into a moral and ethical area where many people would never think of doing some of the things they are being forced to do simply to circumvent this law. And this is very, very sad because it only adds to the stress and trauma that is already out there. And it just speaks even more loudly for some corrections that need to be made in this area.

Mr. **Penny**. Thank you very much, Mr. Chairman.

Mr. **Bedell**. Mr. Lightfoot.

Mr. **Lightfoot**. I only would want to echo Cooper's remarks. If it will help in the southern counties, one county that I am aware of, the ASCS personnel are estimating that there will be roughly 30 percent of that county that will not be farmed this year.

If you want some worst-case scenarios, we can go down the Missouri line and really find a bunch of them. I think that is where the worst part of it is, in the State. Would you gentlemen agree with that, for the most part?

Mr. **Steffen**. Right.

Mr. **Plagge**. Yes.

Mr. **Steffen**. I am sure that Congressman Lightfoot can find you all kinds of examples of that.

Mr. **Lightfoot**. We got the worst of the worst. But it is serious.

Mr. **Bedell**. We appreciate very much your testimony. Thank you very much for being here.

Our next panel consists of Chuck Hassebrook of Walthill, NE, Center for Rural Affairs; Wayne Northey from my home town of Spirit Lake, an Iowa farmer representing the Iowa Cattlemen's Association; and Leo Stephas from Ruthven, an Iowa farmer representing the Iowa Pork Producers Association.

We will start with you, Mr. Hassebrook.

STATEMENT OF CHUCK H. HASSEBROOK, TAX ANALYST AND FIELD ORGANIZER, CENTER FOR RURAL AFFAIRS

Mr. **Hassebrook**. Thank you very much. I am with the Center for Rural Affairs, which is a family-farm advocacy and research organization at Walthill, NE.

I would like to commend you for holding this hearing. I think it is very appropriate. I think, frankly, the change in the tax code is one of the most meaningful things that Congress could do in the long run to maintain family farm profitability in the entire family farm system.

So, I very much appreciate the attention being placed on this issue.

I will focus my remarks briefly on the effects of some of the current tax shelters in agriculture but primarily on the impact of the President's tax proposal on tax sheltering and farming.

I think the basic concept that the Treasury Department began with, of eliminating tax shelters across the board and lowering tax rates for people, is very good and will be very good for farming, although I am concerned that the effectiveness of the Treasury I proposal has been lost in President Reagan's latest proposal because, frankly, I think they have caved in to too many special interests and giving back way too many tax shelters.

I think we have to come to realize that in general tax shelters are just not good for family farming across the board, for a number of reasons. The simplest one, and I think that the clearest one, is simply that, when you make something a tax shelter, the profitability of that industry is going to be lower; there is almost no way around it. The best example we have talked about today is the hog industry. When we made the hog industry a tax shelter in the late 1970's, it was like a magnet for investment in hog buildings. We got more hog buildings. We got more hogs, and we are getting a lower price. There is almost no way around that relationship.

The second we have to recognize is that it changes all the rules of competition. People who think they are benefiting from a tax shelter, possibly getting $1 of benefit, where the competitor is getting $10, are in the long run losing their ability to compete. They can't compete in the land market. They can't produce hogs at the lower price that results. And basically, they lose their long-run ability to compete in the industry. Suddenly it is not enough to produce efficiently. You have to be able to compete in terms of how effectively you can exploit a tax shelter. That depends on having a higher income and having the capital to make the kinds of tax favored capital investments the Tax Code rewards.

Finally, I think we have to recognize that the tax code affects every farmer, not just nonfarmers. It encourages every farmer to get bigger and replace labor with capital. The result of that is that we have much bigger farms and a lot fewer of them. That has very profound impacts for rural Iowa, Minnesota, and Nebraska, all the way down the line.

As far as the President's plan, there are some specific provisions in that bill, I think, that would help by eliminating some of the harmful tax shelters in agriculture, for example, eliminating the capital gains exemption on breeding stock. The capital gains exemption is a direct incentive to overexpand the breeding herd. We get more cattle. We get more hogs. And we get a lower price. Like all these other tax shelters, it grants an advantage to the higher bracket taxpayer.

Eliminating the investment credit is a good thing, I think, because it is simply an incentive for more investment and more production and lower prices and again an incentive for bigger and fewer farms.

I think eliminating the provisions for clearing land and leveling land to convert existing timberland or wetlands or marginal range lands out in the sand hills of Nebraska, subsidizing the conversion of that to crop land is not good. And eliminating those provisions such as the President's plan does, will be very good. I think the lower tax rates will be good for most family farmers.

However, I am concerned that there are also a great number of farm tax shelters that are maintained in the President's proposal that will be pretty damaging, for example, the capital gains exemption is maintained. That means that we continue to give a tax break to an investor or to income made by speculating in farmland relative to income made by farming it. I see no rationale for that. That means that people with higher incomes will gain a competitive advantage in the land market and end up owning more of it. And I think it means we will continue to have a volatile land market.

When you have a capital gains exemption, it's a very strong incentive for tax motivated investors to buy land when the price is going up. So, when you already have good times and appreciating land, the capital gains exemption says: come on, get in on that capital gain, get in on that appreciation, speculate in land because it's tax favored. So, you get more investment. It drives the price of land beyond the point at which people who want to buy land can make a living by farming it can afford.

We are paying the price of that today, because that overpriced land is taking a lot of people down today. And then in the bad times there is no more appreciation. When land is not going up, the capital gains exemption isn't of any value. The effect on the land price becomes inoperative. The tax component comes out of the land price and it at least increases the severity of the crash down, and people lose their collateral base.

I think in the long run, if we were to eliminate the capital gains exemption, land would not get so overbid in the good times. Consequently, it wouldn't crash back down in the bad, at least not to the extent it does now.

Another area where I was frankly disappointed in the President's proposal has to do with hog buildings. Hog buildings would be depreciated in 7 years as with poultry buildings and dairy buildings under the President's proposal. That is, frankly, too short. Hog buildings will still be a tax shelter investment under the President's proposal. We will still have chronic overinvestment subsidized by the tax code and low hog prices.

We will still have corporations looking to invest in the hog industry. And we will still have a strong trend toward bigger and fewer hog farms subsidized by the Tax Code.

Another area where the President's plan reinstated a tax shelter that was eliminated in the Treasury I proposal is in the area of the graduated corporate tax rates. My concern here is that with the very low rates on the first $75,000 or $100,000 of corporate income, very high income farms can split their income up between the personal side and the corporate side and completely avoid the progressivity of the Tax Code.

We can look at some examples under current law. An incorporated farm with $100,000 net income can end up paying an average tax rate of about 12 percent, which is no higher than a nonincorporated farmer making about a third as much money. So, we lose progressivity.

The other side of that is in return for getting the tax break, that farm, once incorporated, has to keep growing because it has to reinvest that corporate income in expansion, because if it pays it out in dividends, it gets a double tax. So, what we say to the larger farms with high incomes is: keep growing, we won't make you pay the progressive tax rates. Again, the result of that is much bigger farms and a lot fewer of them. I think we have to ask whether that is good for this part of the country.

Finally, an area where the President's plan is weak, I think, is that it does nothing really to effectively address tax shelter cattle feeding. Cash accounting and, to a certain extent, capital gains are the two primary tools that I have seen used in tax shelter cattle feeding. As far as capital gains, it would be limited to farms with less than $5 million gross. But, frankly, that is no real obstacle to tax shelter cattle feeding because the investors will just package the tax shelter investments in smaller amounts. And that can easily be avoided.

On the capital gains side, we have seen Hitch Enterprises, a big feed lot that feeds for investors in Oklahoma, work these deals where a corporation goes in, formed by investors to feed cattle. In the early years they have losses and pass them through to the individuals. And then in the later years the profit all goes into the corporation, and they eventually take it out in the form of stock, appreciated stock which then is capital gain. That would continue also.

So, this proposal really does nothing to address the unfairness in the cattle feeding industry today. We will continue to see cattle feeding, I think, move more into lots feeding for tax shelter investors.

I think we also have to look at the revenue impact of keeping all these tax shelters in the President's proposal. One impact is that the Treasury Department had to eliminate income averaging to make up for the revenue loss from capital gains and all these other shelters that were reinstated.

I think income averaging is a very legitimate tool for people like farmers and small business people with very volatile incomes who aren't taxed more than they are able to pay. I see no good solid policy reason for eliminating income averaging. Yet, it is being done in the President's proposal so we can cover the cost of reinstating tax shelters, which I see very little reason for, such as the capital gains exemption and things of that nature.

Finally, this proposal right now with all the tax shelters added back in will increase the deficit. That is the last thing we need in agriculture, bigger deficits. It means higher interest rates, less grain exported, more beef imported, and more pork imported. So, I think that is bad.

I would like to throw out a couple of suggestions as to how the proposal might be improved.

Congressman Lightfoot asked the question about the deduction of so-called conservation expenses, which people will come in and knock down ridges in the sand hills and deduct as conservation expense. The President's proposal eliminates that deduction. No more could you come in with a bulldozer, knock out trees or knock down ridges for farming land and deduct as a conservation expense. However, you would also not be able to deduct the cost of building a terrace, which I think is a legitimate conservation expense.

I am wondering if there might be a good compromise here. It goes along the lines of a very good proposal that Senator Grassley had last year, to close the shelter on hog buildings and use the money to fund conservation credits. The compromise might go like this: Go to the Treasury Department and say, look, we're willing to give up another tax break.

Let's depreciate hog buildings over their useful life. We think that would be good for the industry. It would make the hog industry more profitable. And then take the extra revenue that is gained by the Government from that and use it to offset the cost of allowing people to deduct reed conservation expenses, conservation expenses such as terraces that are certified by the Soil Conservation Service as absolutely reducing soil erosion and that are part of a conservation plan.

So, I will leave you with that suggestion. I appreciate your time.

Mr. **Bedell**. Thank you very much.

Mr. Northey.

STATEMENT OF WAYNE NORTHEY, CHAIRMAN, TAX COMMITTEE, IOWA CATTLEMEN'S ASSOCIATION, ACCOMPANIED BY LARRY RICHARDS, VICE CHAIRMAN, AND BOB ANDERSON, EXECUTIVE VICE PRESIDENT

Mr. NORTHEY. Thank you. We of the Iowa Cattlemen's Association really appreciate the opportunity of participating in this hearing and appreciate the fact that it is out in our area.

I am accompanied today by Larry Richards of Charles City, the vice chairman of our tax committee, and Bob Anderson, the executive vice president of ICA. I am Wayne Northey, a farmer and cattle feeder near Spirit Lake. We will be speaking on behalf of, and I am serving as chairman of the tax committee of the ICA.

We of the ICA have long been concerned with the present tax structure and have been an advocate to reform the tax code on an across-the-board basis including agriculture, but not limited to agriculture.

The major tax proposals have focused on cash-basis accounting, capitalization of preproduction expenses, capital gains, investment tax credit and accelerated depreciation. Each of these have an effect on agriculture and all industries in general. We feel that no segment of the economy should be singled out to benefit over the others.

The major effort in a general tax reform should be to lower marginal tax rates. Lower tax rates effectively reduce the incentive to seek tax shelters and stop abusive practice such as deferring income generated from nonagricultural sources from 1 year to the next in agriculture-related industries such as cattle feeding.

Changes in the depreciation system would be more positive if they reflected the useful economic life and were more evenly distributed over that time period. The current accelerated cost recovery system is an incentive for tax sheltering and probably should be reviewed and possibly eliminated.

The overall benefit that has been derived from the fast tax write-off can be reflected in lower overall tax rates. The investment tax credit has been useful and a key factor in making business investments, but it does provide to bias or distort investment decisions especially when coupled with the accelerated depreciation system.

Cash-basis accounting has been singled out as a key factor in the tax reform proposals. Cash basis is the standard of the industry for agriculture and allows farmers some variance in a business that is so volatile due to weather conditions and market fluctuations. The abuse of the system should be eliminated, not the basic system itself.

The capitalization of preproductive expenses of any agricultural commodity that will not be productive within 2 years will impose a burden on the cow-calf operators. They will have to keep a separate set of records on replacement heifers, and those costs will then have to be depreciated over their useful life. This proposal would increase the cost of replacement heifers and would force an accounting system on the operator.

The ICA has long been concerned about the present tax structure and has advocated changes that would limit tax shelter incentives in agriculture in general. More specifically, in the cattle industry.

Our policy states that we believe that investments in agriculture should be made on an economic basis exclusive of tax considerations and that outside investments should be made strictly on an economic basis and not primarily on a tax incentive basis. That, by the way, is a policy of the ICA and the National Cattlemen's Association, as you folks probably are aware.

Efforts to restrict farm losses used to offset nonfarm income must be carefully scrutinized so that it distinguishes the difference between the persons engaged in agriculture for an economic investment and the person only interested in tax advantages. Caution must be taken so that a bona fide farmer would not be restricted from diversifying his operation to include a nonfarm business or penalizing the farmer with existing off-farm business requiring him to pay taxes even when money was being lost.

H.R. 2425, a bill to amend the Internal Revenue Code of 1954 with respect to the tax treatment of farming, has been introduced that we feel has merit to eliminate some of the abusive tax sheltering of nonfarm profits with farm losses.

One of the provisions would reduce the benefits of investment tax credits derived from farm property by taxpayers who are not primarily engaged in agriculture. For taxpayers who do not derive 50 percent or more of their gross income from farming, the investment tax credit would be reduced 2 percentage points for each gross income percentage change below 50 percent. For example, if gross income from farming equals 49 percent, the investment tax credit would be reduced by 2 percent.

A key provision provides for the inclusion of farm deductions as tax preference items in computing minimum taxes. This proposal would mean that high income corporations and individuals who do not derive 50 percent of their gross income from farming would be less likely to shelter income by participating in temporary agriculture investments like cattle feeding.

Another provision repeals the special treatment for single purpose agricultural structures. Current law provides for a 5-year depreciation schedule and a 10-percent tax credit. This has been an incentive for outside capital because of the tax benefits, and it also has artificially stimulated production regardless of demand.

The Iowa Cattlemen's Association is extremely interested in a provision that would increase the investment credit for farmers undertaking conservation practices on high erodable land. The Iowa Cattlemen's Association initiated legislation in the last session of the Iowa Legislature that would encourage reseeding hilly and fragile land to grasses and legumes. We will also support the repeal of expense treatment for expenditures to clear land.

Another idea that was addressed by the Iowa Legislature this session and should be considered by Congress is the elimination of alternative minimum tax for insolvent farmers. During this period of economic crisis in agriculture, many farmers have sold out and turned over the proceeds to the lender, only to be faced with an unforeseen tax burden.

According to the spring 1985 Iowa Farm and Rural Life Poll conducted by Iowa State University, 88 percent of the 1,800 farmers responding to the poll said that U.S. income tax laws encourage many nonfarmers to invest in agriculture. Only 6 percent respond-ed there was no encouragement for outside investors. The poll also revealed there wasn't any clear-cut consensus among farmers that the elimination of investment tax credit, accelerated depreciation, and capital gains exemptions would help the family farm.

The percentage of cattle fed strictly for tax sheltering has been a major concern of Iowa's cattle feeders for many years. The study of the cattle industry by Cattle-Fax released last November revealed that about 17 percent of the cattle fed in 1984 in the Texas feedyards surveyed were characterized as being tax sheltered. However, the study did not reveal that a significant number were placed on feed during the last quarter to take advantage of having cattle on feed a relatively short time period before the end of the calendar year to enable them to make a capital expenditure for prepaid feed and services.

As many of you know, this study was done by Cattle-Fax, a research organization in Denver, and was commissioned by the Iowa Cattlemen's Association.

In summary, the Iowa Cattlemen's Association and the National Cattlemen's Association have active tax committees. We are analyzing every tax reform proposal, and we are supportive of reform that would change the inequities and abuses of the present Tax Code. We believe the following items should be considered: the tax structure should be simpler and fairer, cash accounting should be retained, the depreciation system can be made more equitable, investment tax credit is helpful, but distorts investment decisions, capital gains treatment should be maintained, the tax rates must be lowered significantly, and changes should be made on an across-the-board basis.

We really appreciate the opportunity to appear here and would be glad to answer any questions you might have.

Mr. Bedell. Thank you very much.

Mr. Stephas.

STATEMENT OF E. LEO STEPHAS, MEMBER, LEGISLATIVE COMMITTEE, IOWA PORK PRODUCERS ASSOCIATION

Mr. Stephas. Thank you, Congressman Bedell, Evans, and Penny.

My name is Leo Stephas. I am a pork producer from Ruthven, IA. I farm about 700 acres, and I basically in corn and soybeans, with a few acres of oats. I raise approximately 2,000 head of hogs. Incidentally, because of financing, we are going to go to sell feeder pigs here to try to save some cash flow situations.

I am here today as a member of the legislative committee for the Iowa Pork Producers Association. On behalf of the 30,000 members statewide, we appreciate the opportunity to comment on tax matters relating to agriculture and, more specifically, pork producers.

I apologize for having to read this today, but I was planting beans until about 10:30 last night and am not quite awake yet to memorize all this.

First, we realize the income tax system in the United States has become enormously complex. In many respects, this issue has masked what is really happening in agriculture with respect to taxes and with respect to the profits Iowa agriculture so desperately needs today.

Our pork producing members prefer a much more simplified system. Our association would support and encourage a code which not only is much easier to understand but ultimately easier to prepare.

Our association has been involved in several tax matters relating to agriculture in the past. Part of the problem again is that the current complexity of the code masks many of what we feel to be the real culprits in bad tax laws which in effect make tax brackets more important than efficiency in production. Our main concern today is Iowa agriculture. It is in such an anemic condition as far as profitability and to stop the erosion of capital assets that there is a real debate in whether or not outside investors should be encouraged or discouraged. Our members and organization clearly feel they should be discouraged.

We acknowledge some provisions of the Income Tax Code have operated to encourage production for farm commodities, including the production of pork, and have afforded tax shelter opportunities to high tax bracket investors who are less motivated by profit than the long-term sound production objectives of these typically farm families.

The pork industry as well as agriculture must be based on long-term objective. In my operation I am most concerned about the quality of the hogs I produce for the consumer. Not only must the product to be produced be a safe product and wholesome, it must be lean, efficiently produced, and what the consumer desires.

These objectives cannot be realized with quick tax saving efforts. Frankly, that ability isn't good for me and in the long run not good for the consumers. For these reasons, we would like to make the following recommendations.

First, we endorse efforts at tax simplification. The more complex the Tax Code, the more loopholes and breaks will be included. These work against producers who are legitimate in their effort to reduce costs and increase efficiency.

Second, we would urge major tax proposals be analyzed as to the impacts of the loss of long-term capital gains treatment for breeding animals. The Tax Code rewards tax sheltered pork producers who use all gilt breeding herds, in spite of the inefficiencies of this practice.

Gentlemen, off the record. Most of us who are serious about this, we keep sows because we can get more efficient production, more pigs, and higher profit because of doing this. But the capital gains by return in gilts, very often it is a big economic advantage to tax sheltered people.

Third, we would endorse efforts reviewing the loss of investment tax credit and modification of the accelerated cost recovery system on depreciation. We feel investment tax credit is necessary on single purpose structures, but the tax savings under the faster writeoff gives the taxpayer the use of money now rather than having to wait for it. The economic benefit of the faster writeoff is about equal to the interest the taxpayer would otherwise have to pay on borrowed money. For the large investor this amounts to a no-interest loan, which is not available to a beginning farmer.

As a side light, I don't know many hog producers in the last 5 years that have had to use their investment credit at all. The fact is I would be glad to pay some taxes for a change.

Fourth, we feel changes in tax laws should not encourage tax shelter activity and should not encourage artificially high levels of investment in facilities.

I do want to jump back once to the capital gains provision. I am not for certain, but I believe I have heard at the board of trade you can take a position for 6 months and get a capital gains on it. I hold my beans for 9 months and I don't get a capital gains. I think we have got an inequity here that I would like to be able to see changed. At least put me on equal footing with them.

As policymakers, we know we have your support on these issues. We hope you are able to convince others to allow U.S. producers to do what they know best: produce efficiently.

On behalf of the association, I want to thank you for your attention and consideration and the opportunity to present our ideas. If you have any questions, I will be glad to try to answer them.

Mr. **Bedell**. Thank you very much.

We have a statement here by Delmar Aastrup of Clear Lake, IA. I would ask permission that it be entered in the record. Without objection, it will be entered.

[The prepared statement of Mr. Aastrup appears at the conclusion of the hearing.]

Mr. **Evans** of Iowa. Is it my time, Mr. Chairman?

Mr. **Bedell**. Yes.

Mr. **Evans** of Iowa. One point that comes to mind hasn't been mentioned today, but you sort of touched on it, the fact that you haven't been able to use or a lot of farmers have not been able to use investment tax credits because they haven't had any income and that sort of thing.

One of the proposals that has been made is that we do for farmers essentially what was done for industry a couple of years ago, recognizing the fact that the one thing that all farmers have to sell that is of no value to them right now—not all farmers, but some—is accumulated and unused investment tax credits and the like, which they have not been able to use by virtue of the fact that they have not had profits.

But the proposal has been that perhaps farmers should be allowed to sell those accumulated investment tax credits to others for a year or two, clear the books and get some cash, maybe 25 cents on the dollar out of those.

Do you have any reaction to that proposal? You understand what I mean, don't you?

Mr. **Stephas**. I do have a reaction. This is my personal opinion. I wouldn't favor that. It becomes another tax loophole that the tax shelter people that are using already, they'll make better use of it than those of us on the farm. Besides, what farmer can I sell it to? I don't know any that could buy it.

Mr. **Evans** of Iowa. Well, you could sell it to somebody other than the farmer.

Mr. **Stephas**. But I would be out proposing something that I don't believe in.

Mr. **Evans** of Iowa. You're not in favor of that.

Mr. **Stephas**. That's right.

Mr. **Evans** of Iowa. Mr. Hassebrook, going to your testimony for just a minute on the capital gains and your opposition to that, you had some very good points and arguments through there.

There is another side of the coin on capital gains—I think there are two. One is that when there is no preferential treatment for capital gains and all that accumulated value is subject to taxation as ordinary income. There has been in other industries and in other instances a strong inclination of the owners not to sell at any price because of the tax consequences of doing that.

Have you taken that into account in your analysis and in arriving at your position? My point is, you could get families or individuals holding onto land forever and ever and ever because they don't want to sell it because of the tax consequences. This could conceivably lead to a substantial amount of land being essentially perpetually held off the market.

Do you accept that analysis at all or not?

Mr. **Hassebrook**. Well, I suppose that could be a problem. I think there would be ways of remedying that without a capital gains exemption. I think one thing that would help—and I agree wholeheartedly with, if we eliminate capital gains exemption, indexing land, so you are only taxing the real gain and not the artificial gain.

Beyond that, there would be a number of ways of doing that. One, I think, would be to tax capital gains at death so capital gains is taxed once every lifetime. I think that would tend to discourage the kind of concentration of wealth you are talking about. You could have some sort of an exception for a certain amount of property.

But I think that proposal would go directly to the heart of concerns about concentration of wealth which, frankly, is encouraged by the capital gains exemption because it is those people who can best use the exemption and would then gain an advantage in bidding for land.

Mr. **Evans** of Iowa. Thank you, Mr. Chairman.

Mr. **Bedell**. Mr. Penny.

Mr. **Penny**. I have a question for Mr. Hassebrook.

Have you evaluated the impact on farmers under the Treasury II proposal in terms of their Social Security tax liability?

Mr. **Hassebrook**. No, I haven't.

Mr. **Penny**. I was curious about that because an initial review of that proposal seems to indicate that, though there might be other benefits in the plan to the family farmer, there is going to be a significant jump in the amount of their income that is going to be subject to that Social Security tax.

I just think that is something that we have to be careful about as we analyze these reforms, and what will be added to their income level for Social Security tax purposes.

I don't have any other questions for the other gentlemen.

Mr. **Bedell**. Getting back to the capital gains situation, we haven't had a chance to really go into detail on what the President is proposing. But if he is proposing indexing, and if by indexing we mean to compute the value at real value rather than inflated value, then what would be wrong with eliminating capital gains if you did that?

Mr. HASSEBROOK. I think that is the absolutely most logical way to do it.

I am not certain of this, but I believe that indexing is eliminated from the second proposal. The first proposal said you index and tax it as ordinary income. I believe the second proposal retains the capital gains exemption but doesn't index. Am I incorrect on that?

Mr. BEDELL. The information we have is it does both. I don't know if the information is accurate or not.

Mr. HASSEBROOK. You may be correct. I haven't actually read it. I have just talked to some people in Treasury. But if that is correct, capital gains——

Mr. BEDELL. In an interview with John Block, he indicates, if I read it correctly, that they have done both. It seems to me that would make things worst rather than better.

Mr. HASSEBROOK. Yes, that would be a great tax shelter if that's true. I mean, it's even better than ever.

Mr. BEDELL. Do you see any problem? Do you understand what we're talking about, Wayne? Assume you bought land for $1,000 and it went up to $2,000. But inflation had been such that that $2,000 would only buy $1,200 worth of assets based upon the original $1,000 value. Do you follow me?

Mr. NORTHEY. Yes.

Mr. BEDELL. Then you would pay full income tax on $800 of appreciation.

Supposing it went up to $1,500, and that would only buy $800 worth of assets, you would then have a deduction of $200 because you had lost money on your investment. It seems to me it would remove the incentive to speculate on investments to try to see them appreciate, and you would only make investments if you felt that it was economically advisable to do so because of the real return you could get.

Mr. NORTHEY. I could see some merit in that.

Mr. BEDELL. But if they have done both, they are just encouraging speculation, are they not?

Mr. HASSEBROOK. Yes, but then you are really heavily subsidizing speculation.

Mr. BEDELL. Mr. Stephas, I am a little surprised that you want to keep the tax credits for hog confinement facilities. People I have talked to think that that has been a significant part of the reason that we have big outside corporations going into hog feeding.

Mr. STEPHAS. Yes, you notice we said we would welcome a review of this. And our past position—and I have to speak as an association representative—our past position has been that we have been for the investment credit on specific purpose structures. However, we could look at a review of this thing.

The big point is the accelerated depreciation. We just don't think that is very good at all. That is causing as much a problem as the investment credit or greater. When you depreciate a building in 5 years, that is ludicrous.

Mr. BEDELL. They both, do they not, encourage outside investment?

Mr. STEPHAS. I personally think so, yes. If you had asked me 5 years ago, I would have said no; but I have seen what has happened.

Mr. BEDELL. Yes, that is what I find among my farmers.

Mr. STEPHAS. I think we would really welcome a review of this.

Mr. BEDELL. And you're not so sure as an individual that you necessarily support the investment tax credit?

Mr. STEPHAS. I am speaking as an individual.

Mr. BEDELL. Sure.

Mr. STEPHAS. Today I have got to take our position that we would look at that review and I think it would change.

I am really concerned about this tax loss hog system that's coming in now—Tyson Foods and Bass Brothers—when, in 5 years, if they analyze the pork industry as a business, they couldn't even rate it on the indexes any more, because it has been such a loser, and yet they can come in and put in 1,000-sow units—a number of them—just as a tax shelter.

Mr. BEDELL. Mr. Evans.

Mr. EVANS of Iowa. I have this question, Mr. Chairman.

Does it make a substantial difference to the pork producers whether such a change in the application of tax laws to hog facilities applies only to those which will be built in the future, as opposed to those that are in existence at the present time?

I mean, some people have made some really important commitments to those facilities. To change the law on them in the middle of the stream—would this cause a great problem for some pork producers, as opposed to trying to discourage more commitments to tax shelters?

Mr. STEPHAS. Not the old family-oriented business. I don't know any family pork producer that's building anything other than specifically remodeling and things like that—a nursery goes to pieces, and they have to remodel, but no large complex.

Personally, I can't see retroactive. People have operated under a set of rules in the past, and that's kind of dirty pool to go back and change in the middle of the stream.

Mr. NORTHEY. Mr. Chairman, this a perfect example of the dramatic fluctuations that have occurred in agriculture.

Not too many years ago, we desperately in agriculture needed some tax benefits along this line because of the income level, and now we're at a point where we in agriculture, individuals and the whole industry, are losing so much equity that we're not even talking about improvement of income; we're talking about improvement of ability to get credit.

But we need in agriculture income—net profit income. Credit is important, but that has to be paid back, and if we as an industry lose equity, that tends to make our problem of the interest expense that we in agriculture pay even greater, which is worsening the situation. We need the income for the investments of the time and the financial investments and so forth.

Mr. BEDELL. Mr. Stephas, I'm not sure I completely followed your statement. It says, "The Tax Code rewards tax sheltering pork producers with gilt breeding herds, in spite of the inefficiency of the practice." Can you explain that more fully?

Mr. STEPHAS. Under the present system, you can take a gilt, and breed her, and drop one litter of pigs, and sell her, and when you sell her, let's say she brings $200; 60 percent of that is written off—$120. That leaves only $80 as taxable income. This gilt will produce at least one less pig per litter.

Mr. EVANS of Iowa. Than a sow?

Mr. STEPHAS. Than a sow—than an old sow.

The conception rate will run 15 to 20, even up to 30 percent, less than an old sow. So a farmer operating tries to keep sows, because the operation becomes more efficient.

However, if you're using pork production as a tax shelter, the capital gains on this gilt, you have one litter, get rid of her, bring another one in the herd, and just keep rolling it this way, and this is how it works. It's a tax shelter situation that's being used.

Mr. HASSEBROOK. Could I add something to that?

The University of Nebraska did an analysis of that, and they said that the break-even point between going after the efficiency or going after the tax break was somewhere between the 30- and 35-percent bracket. If you're below that, you should do what's more efficient. If you're above that, you should go with the one-litter gilt system because the tax benefits are greater.

Mr. STEPHAS. If I can go farther on that same study, on a 50-percent tax bracket versus 20-percent tax bracket, to summarize it, after tax they have a loss on the 50-percent bracket because of using gilts. Their per-litter before-tax profits are zero. The 20-percent bracket has a $22 profit. But they get down to the after-tax benefits, and the one-gilt on a tax shelter of 50 percent has a $45 per litter profit, and the other gentleman is down to $22; he has held about the same.

Mr. BEDELL. We thank you very much for your testimony.

This completes the witnesses we had scheduled. If the subcommittee has no objection, we will take about 10 or 15 minutes if anybody from the group would like to make a few comments.

We welcome you here, and we appreciate your interest in being here.

Does anybody have anything that they'd like to add before we close our hearing?

If not, we thank you for being here. We want to particularly thank our witnesses, many of whom have come a long, long distance.

The subcommittee will be adjourned.

[Whereupon, at 11:35 a.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

DISCHARGE OF INDEBTEDNESS TAX PLANNING ALTERNATIVES

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INTRODUCTION

While §61(a)(12) defines "gross income" to include income realized from the discharge of indebtedness, §108(a)(1) provides an exclusion for amounts of discharged indebtedness if:

§108(a)(1)(A) - Discharge occurs in a Title 11 case;
§108(a)(1)(B) - Discharge occurs when taxpayer is insolvent; or
§108(a)(1)(C) - Indebtedness discharged is qualified business indebtedness

Prior to the passage of the Bankruptcy Tax Act of 1980, a taxpayer who was insolvent both before and after a discharge of indebtedness was not required to recognize income or reduce tax attributes (e.g. net operating losses, tax credits, etc.) to the extent of said discharge. Even if a taxpayer were made solvent because of forgiveness of debt, income was only recognized to the extent that the taxpayer became solvent. As a result of these provisions, financially distressed taxpayers were able to discharge indebtedness with little, if any, tax ramifications. Income recognition was permanently excluded with no corresponding reduction in tax attributes.

The Bankruptcy Tax Act of 1980 attempted to remove this tax avoidance feature while providing financial and tax planning flexibility necessary for taxpayers to arrange their affairs. Unfortunately, the advent and expansion of alternative minimum tax has severely undermined the taxpayer's ability to achieve this financial and tax planning flexibility due to the fact that any transfer of property in satisfaction of indebtedness, whether inside or outside bankruptcy proceedings, is treated as a sale or other disposition having potential capital gains/tax preference ramifications. Reg. §1.1001-2(a). This result is consistent whether property is transferred by voluntary deed, forfeiture, foreclosure, abandonment, etc. THE TAXPAYER WITH SUBSTANTIALLY APPRECIATED PROPERTY WHO COULD OTHERWISE AVOID BANKRUPTCY BY VOLUNTARY TRANSFER OF PROPERTY IN SATISFACTION OF INDEBTEDNESS MAY HAVE TO TAKE BANKRUPTCY TO AVOID FEDERAL AND STATE ALTERNATIVE MINIMUM TAX ON CAPITAL GAIN PREFERENCES.

DEFINITIONS

A. Insolvent:

Excess of liabilities over the fair market value of assets. With respect to any discharge, the amount by which the taxpayer is insolvent shall be determined on the basis of the taxpayer's assets and liabilities immediately before the discharge. §108(d)(3).

There is little case law or other authority providing a definitive answer on the nature and extent of assets and liabilities included in this calculation.

1. Intangible Assets: It would appear that both tangible and intangible assets are included in this computation. Davis v. Comr., 69 T.C. 814 (1978).
2. Exempt Assets: Also, it would appear that property which is exempt from the claims of creditors is not included in the asset total. Rufus Cole v. Comr., 42 B.T.A. 1110 (1940), Nonacq. 1941-1 C.B. 13.
3. Liabilities: Both recourse and non-recourse liabilities are included in this calculation.
4. Query: Should contingent liabilities be included in this calculation.

B. Title 11 Case:

A case under Title 11 of the United States Code (relating to bankruptcy) but only if the taxpayer is under the jurisdiction of the Court in such case and discharge is granted by the Court or is pursuant to a plan approved by the Court. §108(d)(2). (NOTE: A receivership or foreclosure proceeding does not qualify as a "title" proceeding. Also, Title 11 proceedings can apply to both solvent and insolvent taxpayers provided the Court has jurisdiction).

C. Qualified Business Indebtedness:

Indebtedness that was incurred or assumed by (i) a corporation, or (ii) by an individual in connection with property used in his trade or business, and such taxpayer makes an election to reduce the basis of his "depreciable property" as used in §1017. §108(d)(4).

This exception to the inclusion of discharge of indebtedness income applies only to solvent debtors outside bankruptcy to the extent of solvency.

BASIC INFORMATION

The following will need to be obtained to provide a minimum of information necessary to determine the ability of the insolvent taxpayer to transfer property in satisfaction of indebtedness without invoking a Title 11 bankruptcy proceeding. The majority of this information is also required to determine the tax consequences of any transaction involving a discharge of indebtedness.

A. Appraisal of Assets: Necessary to determine fair market value of assets at time of discharge of indebtedness.

B. List of Creditors/Indebtedness: Necessary to determine extent of insolvency. Obtain breakdown of principal and interest owed. (NOTE: No income is realized from the discharge of indebtedness to the extent that payment of a liability would have given rise to a tax deduction. §108(e)(2). Tax attributes will not be reduced to the extent of discharged interest expense or other discharged trade or business expense items).

C. List of Assets: Compile a list of assets which the taxpayer is contemplating transferring in satisfaction of indebtedness. Information will need to be obtained regarding original cost, accumulated depreciation, adjusted basis, fair market value, capital gain or loss on disposition, §1245 gain, §1250 gain, original investment tax credit and investment tax credit recapture potential.

D. Tax Attributes: Past income tax returns of the taxpayer will need to be reviewed to determine the extent of net operating loss carryovers, tax credit carryovers and net capital loss carryovers. These tax attributes are required to be reduced to the extent of discharged indebtedness unless the insolvent taxpayer elects to reduce the basis of certain depreciable property in lieu thereof. §108(b)(5)(A). The extent of tax attributes is the crucial information necessary for a decision concerning transfer of property in satisfaction of indebtedness without invoking the protection of Title 11 bankruptcy proceedings.

The order of reduction of tax attributes is as follows:

1. Current year net operating loss and net operating loss carryovers. §108(b)(2)(A). Apply current year net operating loss first. §108(b)(4)(B).

2. Carryovers of §38 general business credit (e.g. investment credit, WIN credit, targeted jobs credit, alcohol fuels credit) and §30 research and experimentation credit. §108(b)(2)(B).

3. Current year net capital loss and capital loss carryovers. §108(b)(2)(C). Apply current year net capital loss first. §108(b)(4)(B).

4. Reduction of basis of "property" of the taxpayer. §108(b)(2)(D).

5. Foreign tax credit carryovers. §108(b)(2)(E).

The reduction of tax attributes shall be made after the determination of regular tax liability for the taxable year of discharge. §108(b)(4)(A). All reductions of tax attributes are dollar for dollar except for tax credits which are reduced fifty cents for each dollar of discharged indebtedness. §108(b)(3)(A) and (B).

Basis reduction, under §108(b)(2)(D), applies to any property, depreciable or otherwise (with the exception of "exempt" property within a Title 11 bankruptcy case), of the taxpayer which remains at the beginning of the taxable year following the taxable year in which discharge of indebtedness occurs. §1017(a). The reduction in basis cannot exceed the difference between the aggregate basis of the property held by the taxpayer immediately after the discharge and the aggregate liabilities of the taxpayer immediately after the discharge. §1017(b)(2). (Note: Reduction amount = adjusted basis (aggregate) minus liabilities (aggregate)).

NOTE: Exempt property is excluded from basis reduction if discharge of indebtedness occurs within a Title 11 bankruptcy case. §108(d)(10) and §1017(c)(1).

NOTE: Basis reduction under §108(b)(2)(D) differs from basis reduction under §108(b)(5) and §108(c). See discussion following Problem 1C.

NOTE: Any remaining balance of discharge of indebtedness income after reduction of tax attributes is permanently excluded from taxation.

E. Current Year Income Tax Projection: Current year income and expense records will need to be reviewed to provide a projection of the tax position of the taxpayer in the year in which transfer of property in satisfaction of indebtedness is contemplated.

PROBLEM 1A: DISCHARGE OF INDEBTEDNESS OUTSIDE BANKRUPTCY

On April 1, 1984, Ben Farmer, single, agrees with his local banker to liquidate his entire farm operation following sale of his 1983 crops. In exchange for Ben's agreement, the banker assures Ben that the bank will pay all of Ben's unsecured indebtedness (miscellaneous farm expenses) so that Ben may avoid bankruptcy and start his life anew. The banker also allows Ben to retain his residence without securing a mortgage on the property. Ben proceeds with the liquidation on this basis by transferring farm real estate to the bank by voluntary deed and liquidating all farm equipment at a local auction. Ben comes to your office early in 1985 for preparation of his 1984 federal and Iowa returns proudly informing you of his new job and the manner in which his financial trouble had been laid aside with the assistance of the local bank.

Insolvency Calculation:

Asset	Cost	Adj. Basis	Liquidation FMV	Debt
Tractor (acq. 4-1-81)	$ 20,000	$ 10,000	$ 12,000	$ 15,000
Combine (acq.4-1-82)	40,000	25,000	30,000	35,000
Cultivator (acq. 4-1-82)	5,000	3,000	8,000	5,000
Land - 200A (acq. 1-1-74)	200,000	200,000	400,000	460,000
Land - 40A (acq. 1-1-79)	70,000	70,000	80,000	110,000
TOTALS	$335,000	$308,000	$530,000	$625,000*
Residence (acq. 6-1-73) (exempt property)	15,000	15,000	15,000	-0-
TOTALS	$350,000	$323,000	$545,000	$625,000

*All debt is recourse debt. Principal = $600,000
Interest = $ 25,000

Amount of Insolvency: $ 95,000
Discharge of Indebtedness: $ 95,000

NOTE: No income is realized from the discharge of indebtedness to the extent that payment of the liability would have given rise to a deduction. §108(e)(2). Therefore, interest indebtedness will not result in income realization upon discharge; and tax attributes will not be required to be utilized to offset this discharge. In a farm setting, all operating expenses other than interest expense (generally unsecured indebtedness) also fall into this category.

TAX PLANNING: As a general rule, all payments made by a debtor are first applied to interest. If significant tax attributes exist and debt will be discharged, the debtor may wish to negotiate with creditors to have payments applied to principal first. Pursuant to §108(e)(2), no income from discharge of indebtedness will be realized to the extent said indebtedness constitutes accrued interest. Thus, no attribute reduction is required to avoid income realization. Tax attributes will be available for utilization against other income.

1984 Income (Without Transfers in Satisfaction of Debt):

Schedule F (Net):	1-1-84 to 4-1-84	$ 8,000
W-2 (Fed. WH = $2,000):	4-1-84 to 12-31-84	12,000

Tax Attributes:

Year	Taxable Income	Unused NOL Carryover	Unused ITC Carryover	Unused Capital Loss
1981	$15,000	0	0	0
1982	0	18,000	4,500	0
1983	0	25,000	0	1,000
Totals	$15,000	$43,000	$4,500	$1,000

Transfer of Assets - Tax Consequences:

Asset	§1245 Gain	Capital/ §1250 Gain (Loss)	Potential ITC Recapture	Discharged Indebtedness
Tractor	$2,000	$ 0	$ 800	$ 3,000
Combine	5,000	0	2,400	5,000
Cultivator	2,000	3,000	300	(3,000)
Land-100A	0	200,000	0	60,000
Land-40A	0	10,000	0	30,000
TOTALS	$9,000	$213,000	$3,500	$95,000

PROBLEM 1B: BANKRUPTCY/§1398(d)(2)(A) ELECTION

Assume the same fact pattern set forth in Problem 1A with the exception that Ben Farmer elects to initiate a Chapter 7 bankruptcy proceeding on April 1, 1984, rather than liquidating his entire farm operation by agreement with his local banker. All assets comprising the farm operation are liquidated during the course of bankruptcy by the bankruptcy trustee. (See discussion concerning application of §1398(f)(2) for significance). Liquidation fair market value of these assets is as set forth in Problem 1. Ben makes a §1398(d)(2)(A) election to treat calendar year 1984 as two taxable years for purposes of filing his 1984 individual income tax returns.

DISCUSSION

SECTION 1398(d)(2)(A): §1398(d)(2)(A) provides an election for the individual taxpayer in a Chapter 7 or Chapter 11 bankruptcy proceeding. Temp. Reg. §7a.2. This section gives the taxpayer the option of allowing his taxable year to continue without regard to the bankruptcy proceedings or electing to treat the taxable year of bankruptcy as two taxable years (i) the first year ending on the day before the commencement of the bankruptcy case; and (ii) the second year beginning on the date of commencement of the case and ending at the taxpayer's normal year-end date. If the election is made, tax liability for the first short taxable year becomes a liability of the bankruptcy estate payable out of estate assets. However, if the bankruptcy estate has insufficient assets to discharge the tax, the taxpayer will remain liable for this liability. The taxpayer will also be liable for the taxes associated with the second short taxable year.

The §1398(d)(2)(A) election must be made on or before the due date for filing tax returns for the first short taxable year (15th day of fourth full month following commencement of bankruptcy case); and is made with the filing of said return. §1398(d)(2)(D). The election can be made without the prior approval of Internal Revenue Service; and is irrevocable when made. §1398(d)(2)(A)&(D). The taxpayer's spouse may join in the election only if a joint return is to be filed for the first short taxable year. §1398(d)(2)(B). An election is not allowed if the debtor has no assets other than exempt property. §1398(d)(2)(C). The election will be voided if the taxpayer's bankruptcy filing is dismissed or converted to a Chapter 13 filing. §1398(b)(1). An amended return must be filed if this occurs after the filing of the taxpayer's return for the first short year. A separate return is filed for each short taxable year with the income annualized as provided in §443(b). §1398(d)(2)(F).

NOTE: If the taxpayer's spouse filed a separate bankruptcy proceeding, it is possible to split a tax year into three short years. (Temp. Reg. §7a.2.)

TAX PLANNING: Generally, the §1398(d)(2)(A) election should be made if the taxpayer has taxable income during the first short taxable year as the taxpayer will be allowed to utilize tax attributes to offset taxable income and tax liability. Otherwise, the bankruptcy trustee succeeds to any and all remaining tax attributes at commencement of the Title 11 case. §1398(g). Any unused tax attributes pass back to the taxpayer at the termination of the bankruptcy estate. §1398(i). If the taxpayer sustained a loss during the first short tax period, no election should be made so as to preserve the loss for deduction on the taxpayer's return for the full taxable year.

First Short Year:
(1-1-84 to 3-31-84)

Taxable Income:	
Sch. F	8,000 *
NOL carryover	(8,000)
	0

Tax Liab. (Fed. only):	
Regular (annualized)	0
Self-empl. tax)	904
	904

* For purposes of this problem, presume allowable depreciation from January 1, 1984, to March 31, 1984, has been deducted for eligible farm assets.

TAX ATTRIBUTES PASSING TO BANKRUPTCY TRUSTEE - §1398(g)
4-1-84

Year	Unused NOL Carryover	Unused ITC Carryover	Unused Capital Loss
1981	$ 0	0	0
1982	12,300	4,500	0
1983	25,000	0	1,000
Totals	$37,300	$4,500	$1,000

NOTE: No attributes would pass from bankruptcy estate on termination.

Second Short Year:
(4-1-84 to 12-31-84)

Taxable Income:	
W-2	12,000
Pers. Exempt.	(1,000)
	11,000
Annualized:	17,300

Tax Liability (fed. only):	
Regular (annualized)	1,649
	1,649
Total Tax Liability: Problems 2A and 2B	2,553

PROBLEM 1C: BANKRUPTCY/§1398(d)(2)(A) ELECTION NOT MADE

Assume the same facts set forth in Problem 1B above with the exception that Ben does not make the §1398(d)(2)(A) election.

Taxable Income:	
Sch. F	8,000
W-2	12,000
Pers. Exempt.	(1,000)
	19,000

Tax Liability (fed. only):	
Regular (Schedule G inc. avg.)	2,470
Self-empl. tax	904
	3,374

NOTE: Net savings from §1398(d)(2)(A) election is $821 ($3,374 - $2,553).

NOTE: Tax attributes passing to bankruptcy trustee on April 1, 1984, would be as set forth in Problem 1A. No tax attributes would pass from bankruptcy estate at termination.

DISCUSSION

§108(b)(5) ELECTION TO REDUCE BASIS OF DEPRECIABLE PROPERTY FOLLOWING DISCHARGE OF INDEBTEDNESS: Presuming depreciable assets remain following discharge of indebtedness, a taxpayer can elect to reduce the basis of these assets as an alternative to the ordered reduction of tax attributes set forth in §108(b)(2) discussed above. Basis reduction under §108(b)(5) is handled in the same manner as set forth above for basis reduction under §108(d)(2)(D); however, basis reduction under §108(b)(5) differs in that it is limited to depreciable property and real property held for sale as inventory. §1017(b)(3)(E)(i). For purposes of §108, depreciable property is defined as property of a character subject to the allowance for depreciation under §167 but only if a basis reduction would reduce the amount of depreciation which would otherwise be allowable. §1017(b)(3)(B).

The extent by which basis of depreciable property may be reduced under §108(b)(5) also differs from the limitations set forth in §108(b)(2)(D). Basis may be reduced by an amount not to exceed the aggregate adjusted basis of the depreciable property held by the taxpayer as of the beginning of the tax year following the taxable year in which discharge occurs. §108(b)(5)(B). Aggregate liabilities of the taxpayer immediately after the discharge are not taken into consideration. Thus, basis could be reduced to zero despite existing indebtedness against the property. Any remaining discharged amount following reduction of basis of assets under §108(b)(5) is exhausted by tax attributes in the manner set forth in Problem 1A.

The §108(b)(5) election is made on the taxpayer's return for the taxable year in which the discharge occurs or at such other time as will be set forth in regulations to §108(d)(8). Generally, the election should be made using Form 982, Adjustment of Basis of Property under Sections 1017 or 1082(a)(2). Once made, the election is only revocable with the consent of IRS. §108(d)(9)(B).

NOTE: A reduction in basis under any of the provisions of §108 is not treated as a disposition subject to investment tax credit recapture. §1017(c)(2). If the property is sold, the basis reduction is treated as additional depreciation pursuant to §1245 and §1250. Thus, the sale will trigger additional ordinary income. §1017(d).

NOTE: Exempt property is excluded from basis reduction if discharge of indebtedness occurs within a Title 11 bankruptcy case. §108(d)(10) and §1017(c)(1).

NOTE: The sequence for basis reduction as set forth in Regs. §1.1017-1 is as follows:

1. Property acquired with the proceeds of the debt;
2. Property securing the debt;
3. Non-inventory property; and
4. Inventory and receivables.

Adjustment for each numerical category is on a pro rata basis.

TAX PLANNING: The election to reduce basis of depreciable property should be made when the taxpayer wishes to postpone gain recognition or avoid utilization of tax attributes to reduce income from discharge of indebtedness (e.g. net operating loss carryover). In the second case, the taxpayer may want to preserve a net operating loss for utilization against income expected in future years. The net operating loss would presumably provide a greater deduction than depreciation which must be allocated over several years.

If the taxpayer wishes to make the §108(b)(5) election, he may wish to acquire additional depreciable property prior to the end of the discharge year so as to maximize basis reduction.

PROBLEM 2A: TAX RAMIFICATIONS OF SOLVENCY RESULTING FROM VOLUNTARY TRANSFER

The following will illustrate the tax ramifications that would result if Ben Farmer became solvent to the extent of $20,000 as a result of a voluntary transfer of assets. For purposes of this example, the following will be assumed:

1. Indebtedness on Ben's combine is lowered from $35,000 to $10,000; and
2. All farm real estate is transferred to contract sellers by voluntary deed in lieu of foreclosure on April 1, 1984. All farm equipment is retained by Ben.

NOTE: The balance of income from discharge of indebtedness after point of solvency is treated in the same manner as discharged indebtedness of a solvent debtor would be. See Problem 3.

Relevant information from Problem 1A, with the above modifications, is set forth below.

Insolvency Calculation:

Asset	Cost	Adj. Basis	Liquidation FMV	Debt
Tractor (acq. 4-1-81)	$ 20,000	$ 10,000	$ 12,000	$ 15,000
Combine (acq.4-1-82)	40,000	25,000	30,000	10,000
Cultivator (acq. 4-1-82)	5,000	3,000	8,000	5,000
Land - 200A (acq. 1-1-74)	200,000	200,000	400,000	460,000
Land - 40A (acq. 1-1-79)	70,000	70,000	80,000	110,000
TOTALS	$335,000	$308,000	$530,000	$600,000*
Residence (acq. 6-1-73) (exempt property)	15,000	15,000	15,000	-0-
TOTALS	$350,000	$323,000	$545,000	$600,000

*All debt is recourse debt. Principal = $575,000
Interest = $ 25,000 (land only)

Amount of Insolvency: $ 70,000 (25,000 int.)
Discharge of Indebtedness: $ 90,000 (25,000 int.)

NOTE: The amount of discharge of indebtedness income eligible for exclusion is limited to the extent of insolvency on principal ($45,000). The amount by which Ben Farmer became solvent ($20,000) would be subject to tax unless depreciable assets were available upon which Ben could elect to reduce basis pursuant to §108(b)(5).

QUERY: Could liabilities or assets have been manipulated prior to date of discharge so that the taxpayer would have been insolvent at said date?

Tax Attributes:

Year	Unused NOL Carryover	Unused ITC Carryover	Unused Capital Loss
1981	$ 0	0	0
1982	18,000	4,500	0
1983	25,000	0	1,000
Totals	$43,000	$4,500	$1,000

Transfer of Assets - Tax Consequences:

Asset	§1245 Gain	Capital/ §1250 Gain (Loss)	Potential ITC Recapture	Discharged Indebtedness
Land-100A	0	200,000	0	60,000
Land-40A	0	10,000	0	30,000
TOTALS	$ 0	$210,000	$ 0	$90,000

1984 Income (Without Transfers in Satisfaction of Debt):

Schedule F (Net):	1-1-84 to 4-1-84	$ 8,000
W-2 (Fed. WH = $2,000):	4-1-84 to 12-31-84	12,000

TAX ATTRIBUTES
12-31-84

Discharged Indebtedness (Principal only) - §108(e)(2) (limited to extent of insolvency)	$45,000
NOL Carryovers - §108(b)(2)(A)	-0-
Investment Tax Credit Carryovers - §108(b)(2)(B)(i) ($4,500 x 2)	9,000 *
Capital Loss Carryover - §108(b)(2)(C)	-0-
Basis Reduction of Assets - §108(b)(2)(D) and §1017 (limited to adjusted basis less liabilities on remaining property)	23,000
Remaining Discharged Indebtedness (excluded from taxation)	$13,000

NOTE: All other tax attributes were utilized against regular tax liability per IRC §108(b)(4)(A), in the same manner as set forth in Problem 1A.

* Remaining investment tax credit carryover ($4,500) resulting from application of alternative minimum tax. §55(c)(3).

PROBLEM 2B: TAX RAMIFICATIONS OF SOLVENCY RESULTING FROM VOLUNTARY TRANSFER - §108(b)(5) ELECTION

Assuming the same facts as set forth in Problem 2A above, this Problem will illustrate the tax ramifications that would result if Ben Farmer had elected to reduce the basis of "depreciable" property under §108(b)(5).

NOTE: Reduction of tax attributes is as set forth for Problem 2A above.

Tax Liability Problem 2A:	$36,104
Less: Tax Liability Problem 2B:	30,104
Tax Savings (§108(b)(5) election)	$ 6,000

TAX PLANNING: Under §108(b)(5)(A), the taxpayer may optimize the election to reduce basis by limiting the reduction to apply only to a portion of income from discharge of indebtedness. In effect, this allows the taxpayer to change horses in midstream. Basis of depreciable property can be reduced to a certain amount, then tax attributes can be utilized against remaining discharged indebtedness.

PROBLEM 3: QUALIFIED BUSINESS INDEBTEDNESS §108(c)(1) ELECTION

Presuming Ben Farmer was solvent both before and after a voluntary transfer of assets in satisfaction of indebtedness, discharge of indebtedness income would only be excludable if the discharged indebtedness met the definition of "qualified business indebtedness" under §108(d)(4) as defined earlier in this outline. Income realized from the discharge of qualified business indebtedness can be excluded from gross income if the taxpayer elects to reduce the basis of depreciable property (including real estate held as inventory) in the manner set forth in the above discussion for elections under §108(b)(5). §108(c)(1). Since the election format and basis reduction limitations are exactly as stated in the discussion for basis reduction under §108(b)(5), no further examples will be provided for this problem. See Problem 2B above.

Income from discharge of qualified business indebtedness will be included in gross income to the extent the taxpayer does not make the §108(c)(1) election or to the extent that discharged indebtedness exceeds the maximum basis reduction available. As under §108(b)(5), basis reduction will be handled in the manner set forth in Regs. §1.1017-1.

NOTE: Tax planning ideas set forth in §108(b)(5) discussion are applicable to the consideration of an election under §108(c)(1). Basis reduction may not be below zero.

MISCELLANEOUS

A. Purchase Price Adjustments:

The 1980 Bankruptcy Tax Act provided a limited exception to the concept of discharge of indebtedness in instances where the reduction of a purchase money debt constituted a purchase price adjustment. §108(e)(5). If the debt of an original purchaser of property is reduced by the original seller of such property and said purchaser is solvent, such adjustment will be treated as a purchase price adjustment and not discharge of indebtedness income.

NOTE: This rule is not elective and does not apply when the purchaser is insolvent or in bankruptcy. The following additional factors must be applicable to the transaction:

1. Reduction of debt by original seller to original purchaser only.
2. Reduction based solely on direct, arms length negotiations between original seller and buyer. Reduction cannot be based on outside factors such as the running of the statute of limitations on the enforcement of the obligation.

NOTE: The purchaser/debtor is required to reduce basis in the property which is subject to the debt. Corresponding depreciation reduction will result, as well as, an increase in the gain or a decrease in the loss that will be recognized if the property is ultimately sold. Since debt reduction under §108(e)(5) is not debt discharge income, the reduction is not subject to later recapture under §1245 and §1250. Immediate investment credit recapture will result as there is no protection under §1017(c)(2) unless debt reduction results in discharge of indebtedness income.

It does not appear that §108(e)(5) of the 1980 Bankruptcy Tax Act was intended to "freeze" prior judicially created purchase price adjustment rules through codification. (See: Luria and Donald, 88-4th T.Mgt., Cancellation of Indebtedness -- Sections 108 and 1017). Prior judicial law generally found no discharge of indebtedness income resulted when a debtor, by direct negotiations with his creditor, succeeded in reducing a liability incurred as part of the original purchase price of property still held by him, and the value of the property had declined at least to a point where it did not exceed the amount of the debt after reduction. This exception was subject to several limitations, as follows:

(1) The purchase price exception was not applicable where the current market value of the property was equal to or greater than the outstanding debt before reduction.

(2) The purchase price exception only applied to purchase money obligations secured by the property. It did not extend to cases involving subsequent borrowings, though secured by the property, or to cases in which the property could be sold free of the encumbrance.

(3) The purchase price exception was limited to direct, arms length negotiations between an

original debtor and original creditor with respect to the purchase price of the property.

NOTE: This judicial exception appears to be available to both insolvent and solvent taxpayers.

Tax Planning: In order to assure application of the purchase price exception under judicial law in existence prior to the 1980 Bankruptcy Tax Act, competent appraisals or other evidence of fair market value of the property at the time of debt reduction should be obtained to show that the value of the property did not exceed the amount of the debt at least as of the time immediately prior to debt reduction. In addition, any documents passing between the debtor and creditor with respect to the debt reduction should reveal a clear intention to effect a reduction in the purchase price of the property.

B. Assumption of Liability by Related Party:

If a taxpayer's debt is paid by a related party assuming the liability, income from the discharge of indebtedness is realized. §108(e)(4). Section 267(b) defines related parties to include the taxpayer's spouse, parent, child, grandchild or any spouse of said child or grandchild.

C. Form 1099 Filings:

The Tax Reform Act of 1984 set forth new reporting requirements which will enable Internal Revenue Service to identify situations where there may be gain on the foreclosure of property or income on discharge of indebtedness. §6050J. Under this section, a lender whose business loan is secured by property; and who in full or partial satisfaction of indebtedness acquires an interest in that property or has reason to know that the property has been abandoned, is required to file a Form 1099 with Internal Revenue Service and furnish a statement to the debtor/taxpayer. §6050J(a) and (e).

While these reporting requirements apply only to lenders who make secured loans in connection with a trade or business, most farm loans will fall in this category.

The above reporting requirements are applicable to acquisitions of property and abandonments of property after December 31, 1984.

D. More Problems for the Bankrupt Taxpayer--§1398(f)(2):

Section 1398(f)(2) provides as follows:

> "In the case of a termination of the estate, a transfer (other than by sale or exchange) of an

> asset from the estate to the debtor shall not be treated as a disposition for purposes of any provision in this title assigning tax consequences to a disposition, and the debtor shall be treated as the estate would be treated with respect to such asset."

Query: As §1398(i) provides that the debtor succeeds to all tax attributes at termination of the bankruptcy estate, this provision seems to provide that gain will be realized to the debtor upon sale or disposition following abandonment of property to the debtor by the bankruptcy trustee (debtor reacquires title) and discharge of the bankruptcy case. The debtor/taxpayer may be able to avoid the implications of this Section if property is disposed of by voluntary deed or culmination of foreclosure proceedings prior to discharge from bankruptcy. See also Bankruptcy Code (11 U.S.C. 505 (b)).

This author feels that Congress did not intend the result of §1398(f)(2) based on a review of comments set forth in the committee reports to the Bankruptcy Tax Act of 1980. One such comment is set forth below:

> "Income tax treatment of debt discharge income in bankruptcy is intended to accommodate both bankruptcy policy and tax policy." Bankruptcy policy is to preserve a fresh start. House Report No. 96-833, 96th Cong. 2nd Sess. (1980).

If the above assumptions are correct, tax legislation is required to correct this result.

E. Realization of Income/Loss Events:

1. Foreclosure: When a mortgage foreclosure sale can be overturned by redemption within a certain period, the taxpayer's foreclosure gain or loss is not realized until the redemption period expires. R. O'dell & Sons Co., Inc. v. Comm. 169 F2d 247. Thus, realization of income or loss occurs under Iowa law at the end of the one year redemption period.

2. Forfeiture/Voluntary Deed In Lieu of Foreclosure: As the debtor is not eligible to redeem property following transfer by either of these means, realization of income or loss occurs upon date of transfer.

F. Legislative Reform: See S.3095 in appendix.

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(Attachments follow.)

PROBLEM 18: DISCHARGE OF INDEBTEDNESS OUTSIDE BANKRUPTCY

On April 1, 1984, Ben Farmer, single, agrees with his local banker to liquidate his entire farm operation following sale of his 1983 crops. In exchange for Ben's agreement, the banker assures Ben that the bank will pay all of Ben's unsecured indebtedness (miscellaneous farm expenses) so that Ben may avoid bankruptcy and start his life anew. The banker also allows Ben to retain his residence without securing a mortgage on the property. Ben proceeds with the liquidation on this basis by transferring farm real estate to the bank by voluntary deed and liquidating all farm equipment at a local auction. Ben comes to your office early in 1985 for preparation of his 1984 federal and Iowa returns proudly informing you of his new job and the manner in which his financial trouble had been laid aside with the assistance of the local bank.

Insolvency Calculation:

Asset	Cost	Adj. Basis	Liquidation FMV	Debt
Tractor (acq. 4-1-81)	$ 20,000	$ 10,000	$ 12,000	$ 15,000
Combine (acq. 4-1-82)	40,000	25,000	30,000	35,000
Cultivator (acq. 4-1-82)	5,000	3,000	8,000	5,000
Land - 200A (acq. 1-1-74)	200,000	200,000	400,000	460,000
Land - 40A (acq. 1-1-78)	70,000	70,000	80,000	110,000
TOTALS	$335,000	$308,000	$530,000	$625,000*
Residence (acq. 4-1-73) (exempt property)	15,000	15,000	15,000	-0-
TOTALS	$350,000	$323,000	$545,000	$625,000

*All debt is recourse debt. Principal = $600,000
Interest = $ 25,000

Amount of Insolvency: $ 95,000
Discharge of Indebtedness: $ 95,000

1984 Income (Without Transfers in Satisfaction of Debt):

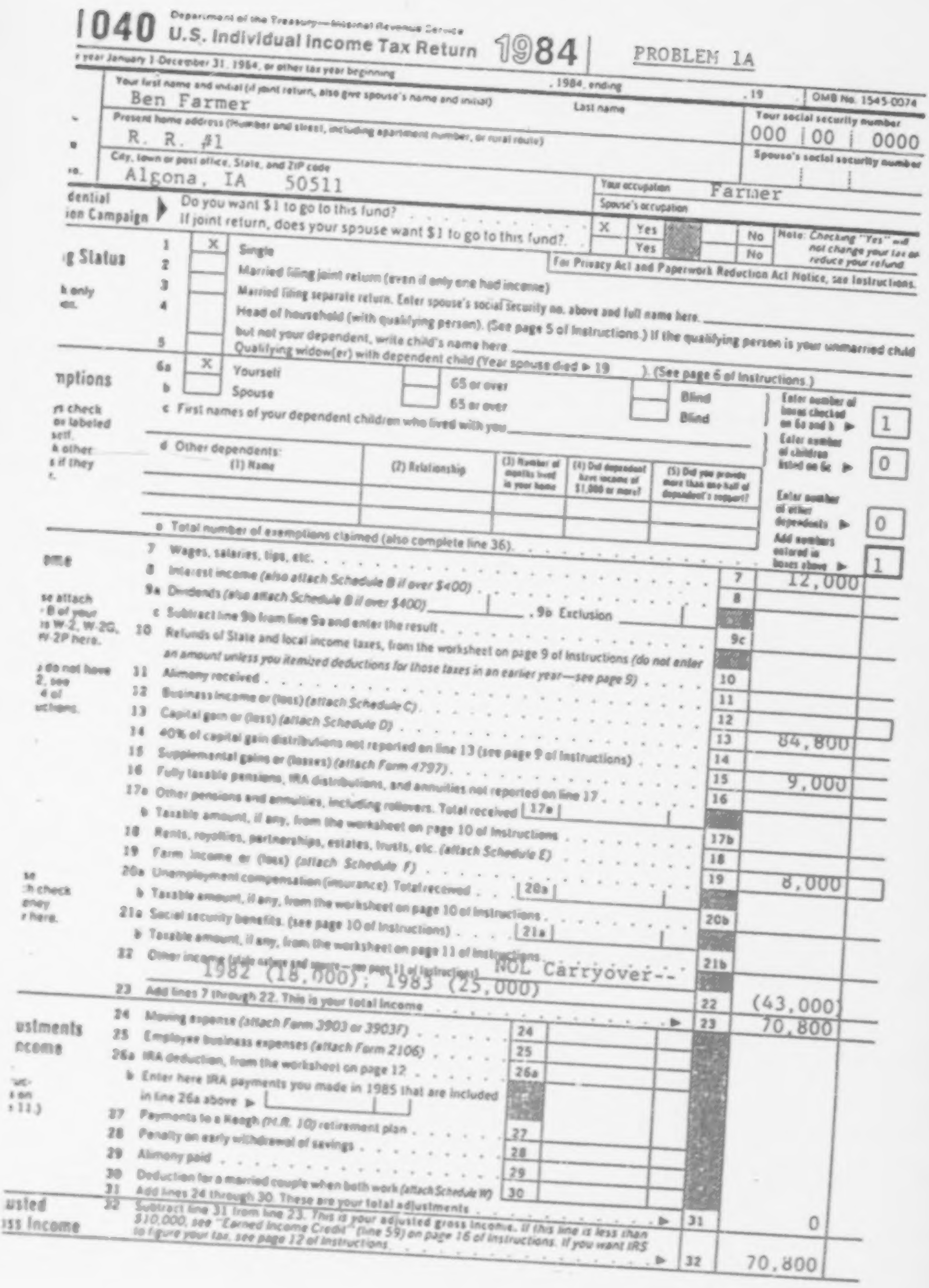
Schedule F (Net):	1-1-84 to 4-1-84	$ 8,000
W-2 (Fed. WH = $2,000):	4-1-84 to 12-31-84	12,000

Tax Attributes:

Year	Taxable Income	Unused NOL Carryover	Unused ITC Carryover	Unused Capital Loss
1981	$15,000	0	0	0
1982	0	18,000	4,500	0
1983	0	25,000	0	1,000
Totals	$15,000	$43,000	$4,500	$1,000

Transfer of Assets - Tax Consequences:

Asset	§1245 Gain	Capital/ §1250 Gain (Loss)	Potential ITC Recapture	Discharged Indebtedness
Tractor	$2,000	$ 0	$ 800	$ 3,000
Combine	5,000	0	2,400	5,000
Cultivator	2,000	3,000	300	(3,000)
Land-100A	0	200,000	0	60,000
Land-40A	0	10,000	0	30,000
TOTALS	$9,000	$213,000	$3,500	$95,000



1040 Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return 1984

PROBLEM 1A

r year January 1-December 31, 1984, or other tax year beginning , 1984, ending , 19 . OMB No. 1545-0074

Your first name and initial (if joint return, also give spouse's name and initial) Last name: Ben Farmer

Your social security number: 000 | 00 | 0000

Present home address (Number and street, including apartment number, or rural route): R. R. #1

Spouse's social security number:

City, town or post office, State, and ZIP code: Algona, IA 50511

Your occupation: Farmer

Spouse's occupation:

dential / ion Campaign ▶ Do you want $1 to go to this fund? ☒ Yes ☐ No

If joint return, does your spouse want $1 to go to this fund? ☐ Yes ☐ No

Note: Checking "Yes" will not change your tax or reduce your refund.

For Privacy Act and Paperwork Reduction Act Notice, see Instructions.

g Status

1 ☒ Single
2 ☐ Married filing joint return (even if only one had income)
3 ☐ Married filing separate return. Enter spouse's social security no. above and full name here.
4 ☐ Head of household (with qualifying person). (See page 5 of Instructions.) If the qualifying person is your unmarried child but not your dependent, write child's name here.
5 ☐ Qualifying widow(er) with dependent child (Year spouse died ▶ 19). (See page 6 of Instructions.)

nptions

6a ☒ Yourself ☐ 65 or over ☐ Blind
b ☐ Spouse ☐ 65 or over ☐ Blind

Enter number of boxes checked on 6a and b ▶ 1

c First names of your dependent children who lived with you

Enter number of children listed on 6c ▶ 0

d Other dependents:

(1) Name	(2) Relationship	(3) Number of months lived in your home	(4) Did dependent have income of $1,000 or more?	(5) Did you provide more than one-half of dependent's support?

Enter number of other dependents ▶ 0

e Total number of exemptions claimed (also complete line 36).

Add numbers entered in boxes above ▶ 1

7	Wages, salaries, tips, etc.	7	12,000
8	Interest income (also attach Schedule B if over $400)	8	
9a	Dividends (also attach Schedule B if over $400) , 9b Exclusion		
c	Subtract line 9b from line 9a and enter the result	9c	
10	Refunds of State and local income taxes, from the worksheet on page 9 of Instructions (do not enter an amount unless you itemized deductions for those taxes in an earlier year—see page 9)	10	
11	Alimony received	11	
12	Business income or (loss) (attach Schedule C)	12	
13	Capital gain or (loss) (attach Schedule D)	13	84,800
14	40% of capital gain distributions not reported on line 13 (see page 9 of Instructions)	14	
15	Supplemental gains or (losses) (attach Form 4797)	15	9,000
16	Fully taxable pensions, IRA distributions, and annuities not reported on line 17	16	
17a	Other pensions and annuities, including rollovers. Total received 17a		
b	Taxable amount, if any, from the worksheet on page 10 of Instructions	17b	
18	Rents, royalties, partnerships, estates, trusts, etc. (attach Schedule E)	18	
19	Farm income or (loss) (attach Schedule F)	19	8,000
20a	Unemployment compensation (insurance). Total received 20a		
b	Taxable amount, if any, from the worksheet on page 10 of Instructions	20b	
21a	Social security benefits. (see page 10 of Instructions) 21a		
b	Taxable amount, if any, from the worksheet on page 11 of Instructions	21b	
22	Other income (state nature and source—see page 11 of Instructions) NOL Carryover-- 1982 (18,000); 1983 (25,000)	22	(43,000)
23	Add lines 7 through 22. This is your total income ▶	23	70,800

usiments / ncome

24	Moving expense (attach Form 3903 or 3903F)	24	
25	Employee business expenses (attach Form 2106)	25	
26a	IRA deduction, from the worksheet on page 12	26a	
b	Enter here IRA payments you made in 1985 that are included in line 26a above ▶		
27	Payments to a Keogh (H.R. 10) retirement plan	27	
28	Penalty on early withdrawal of savings	28	
29	Alimony paid	29	
30	Deduction for a married couple when both work (attach Schedule W)	30	
31	Add lines 24 through 30. These are your total adjustments ▶	31	0

usted / ss Income

32 Subtract line 31 from line 23. This is your adjusted gross income. If this line is less than $10,000, see "Earned Income Credit" (line 59) on page 16 of Instructions. If you want IRS to figure your tax, see page 12 of Instructions. ▶ 32 70,800

Form 1040 (1984) Page 2

Tax Computation (See Instructions on page 13.)	33	Amount from line 32 (adjusted gross income)			33	70,800
	34a	If you itemize, attach Schedule A (Form 1040) and enter the amount from Schedule A, line 26 Caution: If you have unearned income and can be claimed as a dependent on your parent's return, check here ▶ ☐ and see page 13 of the Instructions. Also see page 13 if: • You are married filing a separate return and your spouse itemizes deductions, OR • You file Form 4563, OR • You are a dual-status alien.			34a	
	34b	If you do not itemize deductions, and you have charitable contributions, complete the worksheet on page 14. Then enter the allowable part of your contributions here			34b	
	35	Subtract line 34a or 34b, whichever applies, from line 33			35	70,800
	36	Multiply $1,000 by the total number of exemptions claimed on Form 1040, line 6e			36	1,000
	37	Taxable Income. Subtract line 36 from line 35			37	69,800
	38	Tax. Enter tax here and check if from ☐ Tax Table, ☐ Tax Rate Schedule X, Y, or Z, or ☒ Schedule G			38	13,798
	39	Additional Taxes. (See page 14 of Instructions.) Enter here and check if from ☐ Form 4970, ☐ Form 4972, or ☐ Form 5544			39	
	40	Add lines 38 and 39. Enter the total ▶			40	
Credits (See Instructions on page 14.)	41	Credit for child and dependent care expenses *(attach Form 2441)*	41			
	42	Credit for the elderly and the permanently and totally disabled *(attach Schedule R)*	42			
	43	Residential energy credit *(attach Form 5695)*	43			
	44	Partial credit for political contributions for which you have receipts	44			
	45	Add lines 41 through 44. These are your total personal credits			45	0
	46	Subtract line 45 from 40. Enter the result (but not less than zero)			46	13,798
	47	Foreign tax credit *(attach Form 1116)*	47			
	48	General business credit. Check if from ☐ Form 3800, ☒ Form 3468, ☐ Form 5884, ☐ Form 6478	48	1,000		
	49	Add lines 47 and 48. These are your total business and other credits			49	1,000
	50	Subtract line 49 from 46. Enter the result (but not less than zero) ▶			50	12,798
Other Taxes (Including Advance EIC Payments)	51	Self-employment tax *(attach Schedule SE)*			51	904
	52	Alternative minimum tax *(attach Form 6251)*			52	20,802
	53	Tax from recapture of investment credit *(attach Form 4255)*			53	0
	54	Social security tax on tip income not reported to employer *(attach Form 4137)*			54	
	55	Tax on an IRA *(attach Form 5329)*			55	
	56	Add lines 50 through 55. This is your total tax ▶			56	34,504
Payments Attach Forms W-2, W-2G, and W-2P to front.	57	Federal income tax withheld	57	2,000		
	58	1984 estimated tax payments and amount applied from 1983 return	58			
	59	Earned income credit. If line 33 is under $10,000, see page 16	59			
	60	Amount paid with Form 4868	60			
	61	Excess social security tax and RRTA tax withheld (two or more employers)	61			
	62	Credit for Federal tax on gasoline and special fuels *(attach Form 4136)*	62			
	63	Regulated Investment Company credit *(attach Form 2439)*	63			
	64	Add lines 57 through 63. These are your total payments ▶			64	2,000
Refund or Amount You Owe	65	If line 64 is larger than line 56, enter amount OVERPAID ▶			65	
	66	Amount of line 65 to be REFUNDED TO YOU ▶			66	
	67	Amount of line 65 to be applied to your 1985 estimated tax ▶	67			
	68	If line 56 is larger than line 64, enter AMOUNT YOU OWE. Attach check or money order for full amount payable to "Internal Revenue Service." Write your social security number and "1984 Form 1040" on it ▶ (Check ▶ ☐ if Form 2210 (2210F) is attached. See page 17 of Instructions.) $			68	32,504

Please Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Your signature | Date ▶ Spouse's signature (if filing jointly, BOTH must sign)

Paid Preparer's Use Only

Preparer's signature ▶	Date	Check if self-employed ☐	Preparer's social security no.
Firm's name (or yours, if self employed) and address ▶		E.I. No.	
		ZIP code	

SCHEDULE D
(Form 1040)
Department of the Treasury
Internal Revenue Service (2)

Capital Gains and Losses

(Also reconciliation of sales of stocks, bonds, and bartering income from Forms 1099-B)

▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).

OMB No. 1545-0074
1984
12

Name(s) as shown on Form 1040: Ben Farmer

Your social security number: 000 00 0000

Part I Short-term Capital Gains and Losses-Assets Held One Year or Less (6 months if acquired after 6/22/84)

a. Description of property (Example, 100 shares 7% preferred of "Z" Co.)	b. Date acquired (Mo., day, yr.)	c. Date sold (Mo., day, yr.)	d. Gross sales price	e. Cost or other basis (see instructions)	f. LOSS If column (e) is more than (d) subtract (d) from (e)	g. GAIN If column (d) is more than (e) subtract (e) from (d)
1						

		f. LOSS	g. GAIN
2 Short-term gain from sale or exchange of a principal residence from Form 2119, lines 7 or 11	2	▨	
3 Short-term gain from installment sales from Form 6252, lines 22 or 30	3	▨	
4 Net short-term gain or (loss) from partnerships, S corporations, and fiduciaries	4		
5 Add lines 1 through 4 in columns f and g	5	( )	
6 Combine columns f and g of line 5 and enter the net gain or (loss)	6		
7 Short-term capital loss carryover from years beginning after 1969	7		( )
8 Net short-term gain or (loss), combine lines 6 and 7	8		

Part II Long-term Capital Gains and Losses-Assets Held More Than One Year (6 months if acquired after 6/22/84)

9						

		f. LOSS	g. GAIN
10 Long-term gain from sale or exchange of a principal residence from Form 2119, lines 7, 11, 16, or 18	10	▨	
11 Long-term gain from installment sales from Form 6252, lines 22 or 30	11	▨	
12 Net long-term gain or (loss) from partnerships, S corporations, and fiduciaries	12		
13 Add lines 9 through 12 in columns f and g	13	( )	
14 Combine columns f and g of line 13 and enter the net gain or (loss)	14		
15 Capital gain distributions	15		
16 Enter gain from Form 4797, line 6(a)(1)	16		213,000
17 Combine lines 14 through 16	17		213,000
18 Long-term capital loss carryover from years beginning after 1969	18		(1,000)
19 Net long-term gain or (loss), combine lines 17 and 18.	19		212,000

Note: *Complete the back of this form. However, if you have capital loss carryovers from years beginning before 1970, do not complete Parts III or IV. See Form 4798 instead.*

Schedule D (Form 1040) 1984 12 Page 2

Name(s) as shown on Form 1040 (Do not enter name and social security number if shown on other side)	Your social security number

Part III Summary of Parts I and II

20	Combine lines 8 and 19, and enter the net gain or (loss) here	20	212,000	
	Note: *If line 20 is a loss, skip lines 21 through 23 and complete lines 24 and 25. If line 20 is a gain complete lines 21 through 23 and skip lines 24 and 25.*			
21	If line 20 shows a gain, enter the smaller of line 19 or line 20. Enter zero if there is a loss or no entry on line 19. 21 212,000			
22	Enter 60% of line 21	22	127,200	
	If line 22 is more than zero, you may be liable for the alternative minimum tax. See Form 6251.			
23	Subtract line 22 from line 20. Enter here and on Form 1040, line 13	23	84,800	
24	If line 20 shows a loss, enter one of the following amounts: a If line 8 is zero or a net gain, enter 50% of line 20; b If line 19 is zero or a net gain, enter line 20; or c If line 8 and line 19 are net losses, enter amount on line 8 added to 50% of the amount on line 19	24		
25	Enter here and as a loss on Form 1040, line 13, the smallest of: a The amount on line 24; b $3,000 ($1,500 if married and filing a separate return); or c Taxable income, as adjusted.	25		

Part IV Computation of Post-1969 Capital Loss Carryovers from 1984 to 1985

(Complete this part if the loss on line 24 is more than the loss on line 25)

26	Enter loss shown on line 8; if none, enter zero and skip lines 27 through 30, then go to line 31	26		
27	Enter gain shown on line 19. If that line is blank or shows a loss, enter zero	27		
28	Reduce any loss on line 26 to the extent of any gain on line 27	28		
29	Enter smaller of line 25 or line 28	29		
30	Subtract line 29 from line 28. This is your short-term capital loss carryover from 1984 to 1985	30		
31	Subtract line 29 from line 25. (Note: If you skipped lines 27 through 30, enter amount from line 25)	31		
32	Enter loss from line 19; if none, enter zero and skip lines 33 through 36	32		
33	Enter gain shown on line 8. If that line is blank or shows a loss, enter zero	33		
34	Reduce any loss on line 32 to the extent of any gain on line 33	34		
35	Multiply amount on line 31 by 2	35		
36	Subtract line 35 from line 34. This is your long-term capital loss carryover from 1984 to 1985	36		

Part V Complete this Part Only If You Elect Out of the Installment Method and Report a Note or Other Obligation at Less Than Full Face Value

☐ Check here if you elect out of the installment method.

Enter the face amount of the note or other obligation. ▶ ....

Enter the percentage of valuation of the note or other obligation. ▶

Part VI Reconciliation of Forms 1099-B With Tax Return (Complete this part if you received one or more Forms 1099-B or equivalent statement reporting sales of stock, bonds, etc. or bartering income.)

SECTION A.—Reconciliation of Sales of Stocks, Bonds, etc.

37	Total sales of stock, bonds, etc. from Forms 1099-B or equivalent statement received from your brokers	37		
38	Proceeds from sale or exchange of capital assets reported on Schedule D, but not included in line 37	38		
39	Add lines 37 and 38.	39		
40	Part of line 37 not reported on Schedule D this year, attach explanation	40		
41	Subtract line 40 from line 39.	41		

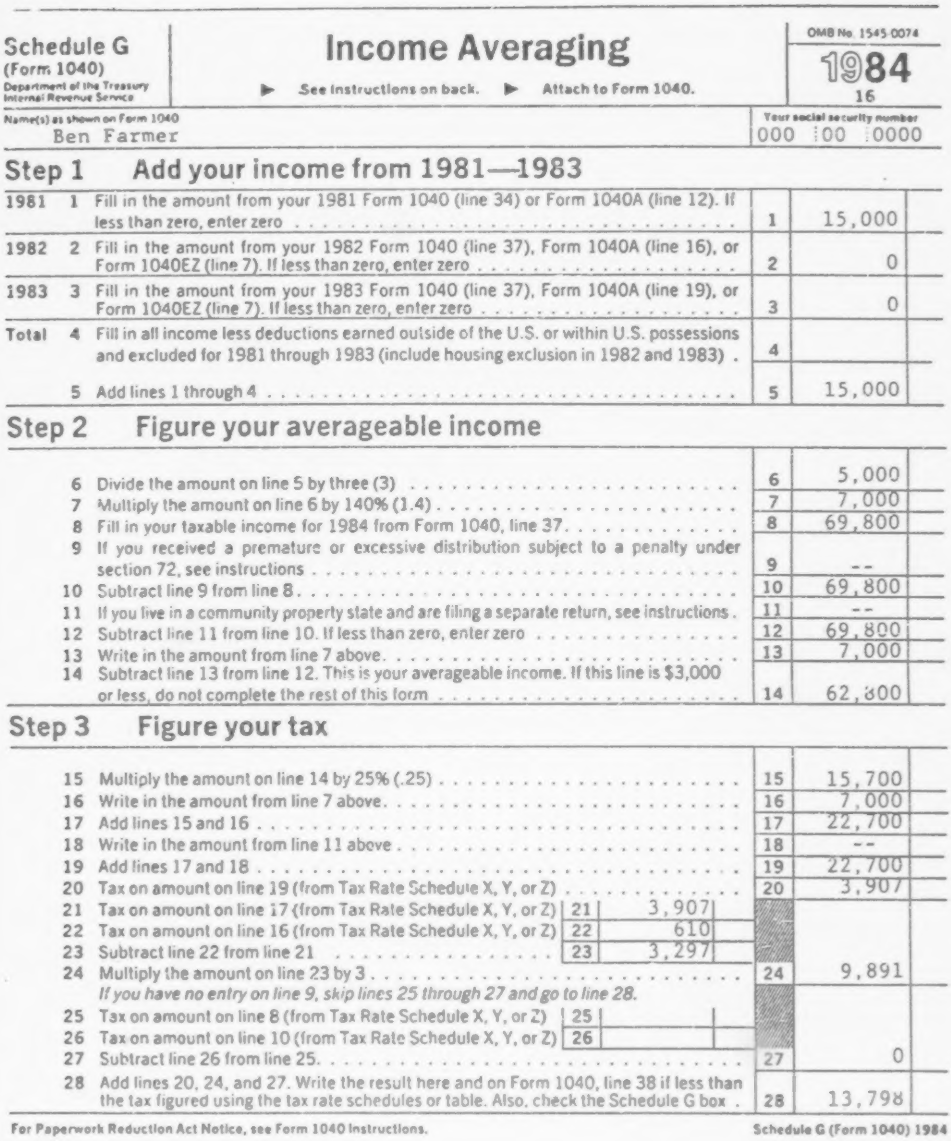
Note: *The amount on line 41 should be the same as the total of all amounts on page 1, lines 1 and 9 of column d.*

SECTION B.—Reconciliation of Bartering Income

Indicate below the amount of bartering income reported on each form or schedule

			Amount of bartering from Form 1099-B or equivalent statement	
42	Form 1040, line 22.	42		
43	Schedule C (Form 1040)	43		
44	Schedule D (Form 1040)	44		
45	Schedule E (Form 1040)	45		
46	Schedule F (Form 1040)	46		
47	Other (identify) (if not taxable, indicate reason—attach additional sheets if necessary) ▶	47		
48	Total (add lines 42 through 47)	48		

Note: *The amount on line 48 should be the same as the total bartering on all Forms 1099-B or equivalent statements received.*



Schedule G
(Form 1040)
Department of the Treasury
Internal Revenue Service

Income Averaging

▶ See instructions on back. ▶ Attach to Form 1040.

OMB No. 1545-0074
1984
16

Name(s) as shown on Form 1040: Ben Farmer

Your social security number: 000 00 0000

Step 1 Add your income from 1981—1983

1981	1	Fill in the amount from your 1981 Form 1040 (line 34) or Form 1040A (line 12). If less than zero, enter zero	1	15,000
1982	2	Fill in the amount from your 1982 Form 1040 (line 37), Form 1040A (line 16), or Form 1040EZ (line 7). If less than zero, enter zero	2	0
1983	3	Fill in the amount from your 1983 Form 1040 (line 37), Form 1040A (line 19), or Form 1040EZ (line 7). If less than zero, enter zero	3	0
Total	4	Fill in all income less deductions earned outside of the U.S. or within U.S. possessions and excluded for 1981 through 1983 (include housing exclusion in 1982 and 1983)	4	
	5	Add lines 1 through 4	5	15,000

Step 2 Figure your averageable income

6	Divide the amount on line 5 by three (3)	6	5,000
7	Multiply the amount on line 6 by 140% (1.4)	7	7,000
8	Fill in your taxable income for 1984 from Form 1040, line 37	8	69,800
9	If you received a premature or excessive distribution subject to a penalty under section 72, see instructions	9	--
10	Subtract line 9 from line 8	10	69,800
11	If you live in a community property state and are filing a separate return, see instructions	11	--
12	Subtract line 11 from line 10. If less than zero, enter zero	12	69,800
13	Write in the amount from line 7 above	13	7,000
14	Subtract line 13 from line 12. This is your averageable income. If this line is $3,000 or less, do not complete the rest of this form	14	62,800

Step 3 Figure your tax

15	Multiply the amount on line 14 by 25% (.25)			15	15,700
16	Write in the amount from line 7 above			16	7,000
17	Add lines 15 and 16			17	22,700
18	Write in the amount from line 11 above			18	--
19	Add lines 17 and 18			19	22,700
20	Tax on amount on line 19 (from Tax Rate Schedule X, Y, or Z)			20	3,907
21	Tax on amount on line 17 (from Tax Rate Schedule X, Y, or Z)	21	3,907		
22	Tax on amount on line 16 (from Tax Rate Schedule X, Y, or Z)	22	610		
23	Subtract line 22 from line 21	23	3,297		
24	Multiply the amount on line 23 by 3			24	9,891
	If you have no entry on line 9, skip lines 25 through 27 and go to line 28.				
25	Tax on amount on line 8 (from Tax Rate Schedule X, Y, or Z)	25			
26	Tax on amount on line 10 (from Tax Rate Schedule X, Y, or Z)	26			
27	Subtract line 26 from line 25			27	0
28	Add lines 20, 24, and 27. Write the result here and on Form 1040, line 38 if less than the tax figured using the tax rate schedules or table. Also, check the Schedule G box			28	13,798

For Paperwork Reduction Act Notice, see Form 1040 Instructions.

Schedule G (Form 1040) 1984

Saves $9,277

166 2-87

Form **982**
(Rev. Dec. 1981)
Department of the Treasury
Internal Revenue Service

Adjustment of Basis of Property Under Sections 1017 or 1082(a)(2) of the Internal Revenue Code

▶ Attach this form to your income tax return.

OMB No. 1545-0046
Expires 11-30-84

Name: Ben Farmer
Identifying number: 000-00-0000

Number and street: R. R. #1

City or town, State, and ZIP code: Algona, IA 50511

Part I Adjustment of Basis of Property Under Section 1017

Taxable year in which amount was excluded beginning Jan. 1, 19 84 ending December 31, 19 84

1 Enter amount excluded from gross income as qualified business indebtedness under section 108(a)(1)(C) and (d)(4) . . -0-

2 Enter amount excluded from gross income which the taxpayer elects to apply first to reduce the basis of depreciable property under section 108(b)(5) . . . . . -0-

3 Do you elect to treat all real property described in section 1221(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? . . . . . ☐ Yes ☒ No N/A

4 Description of property	Basis before reduction	Basis after reduction	Reduction
N/A			
Total			-0-

5 Narrative statement of the transactions resulting in discharge of indebtedness and nature of the discharge. Include date of discharge, amounts of discharge, and whether taxpayer was solvent, insolvent, or in a title 11 case (as defined in section 108(d)(2)) at time of discharge.

See attached schedule

Part II Consent of Corporation to Adjustment of Basis of its Property Under Section 1082(a)(2) of the Internal Revenue Code

The corporation named above has excluded under section 1081(b) of the Internal Revenue Code $ ....

from its gross income for the tax year beginning ...., and ending ....

Under that section the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) of the Internal Revenue Code in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of .... (State of incorporation).

Note: You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.

SIGNATURE

Under penalties of perjury I declare that I have examined this form including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete.

.... Signature—If individual taxpayer .... Date

.... Signature—if corporate taxpayer .... Title .... Date

For Paperwork Reduction Act Notice, see back of form.

Ben Farmer
SSN: 000-00-0000

Attachment to
Form 982

On April 1, 1984, the taxpayer liquidated the assets comprising his farming operation by (1) transferring real estate to ____________________ Bank by voluntary deed in lieu of foreclosure; and (2) sale of all personalty comprising said farming operation at private auction. The result of this liquidation was discharge of indebtedness income, in the amount of $95,000 ($70,000 principal; $25,000 interest). The following information documents taxpayer's insolvency at date of discharge, tax attributes at date of discharge and year end and reduction of tax attributes pursuant to IRC §108(b)(2).

INSOLVENCY CALCULATION
4-1-84

Asset	Cost	Adj. Basis	Liquidation FMV	Debt
Tractor (acq. 4-1-81)	$ 20,000	$ 10,000	$ 12,000	$ 15,000
Combine (acq.4-1-82)	40,000	25,000	30,000	35,000
Cultivator (acq. 4-1-82)	5,000	3,000	8,000	5,000
Land - 200A (acq. 1-1-74)	200,000	200,000	400,000	460,000
Land - 40A (acq. 1-1-79)	70,000	70,000	80,000	110,000
TOTALS	$335,000	$308,000	$530,000	$625,000*
Residence (acq. 6-1-73) (exempt property)	15,000	15,000	15,000	-0-
TOTALS	$350,000	$323,000	$545,000	$625,000

*All debt is recourse debt. Principal = $600,000
Interest = $ 25,000

Amount of Insolvency: $ 95,000
Discharge of Indebtedness: $ 95,000

Ben Farmer SSN: 000-00-0000	Attachment to Form 982 Page 2

TAX ATTRIBUTES
4-1-84

Year	Unused NOL Carryover	Unused ITC Carryover	Unused Capital Loss
1981	$ 0	0	0
1982	18,000	4,500	0
1983	25,000	0	1,000
Totals	$43,000	$4,500	$1,000

REDUCTION OF TAX ATTRIBUTES
12-31-84

Discharged Indebtedness (Principal only) - §108(e)(2)	$70,000
NOL Carryovers - §108(b)(2)(A)	-0-
Investment Tax Credit Carryovers - §108(b)(2)(B)(i) ($1,000 x 2)	2,000 *
Capital Loss Carryover - §108(b)(2)(C)	-0-
Basis Reduction of Assets - §108(b)(2)(D) and §1017	15,000
Remaining Discharged Indebtedness (excluded from taxation)	$43,000

NOTE: All tax attributes were utilized against regular tax liability per IRC §108(b)(4)(A).

* Remaining investment tax credit carryover ($1,000) resulting from application of alternative minimum tax. §55(c)(3).

Form **4255**
(Rev. Nov. 1982)
Department of the Treasury
Internal Revenue Service

Recapture of Investment Credit

(Including Energy Investment Credit)

► Attach to your income tax return

OMB No. 1545-0166
Expires 11-30-85

65

Name(s) as shown on return Ben Farmer	Identifying number 000-00-0000

Properties	Kind of property—State whether recovery or nonrecovery (see Form 3468 instructions for definitions). If energy property, show type. Also indicate if rehabilitation expenditure property.
A	Tractor
B	Combine
C	Cultivator
D	
E	

Original Investment Credit

Computation Steps: (see Specific Instructions)	Properties A	B	C	D	E
1 Original rate of credit	10%	10%	10%		
2 Date property was placed in service	4-1-81	4-1-82	4-1-82		
3 Cost or other basis	20,000	40,000	5,000		
4 Original estimated useful life or class of property	5 yrs.	5 yrs.	5 yrs.		
5 Applicable percentage	100%	100%	100%		
6 Original qualified investment (line 3 times line 5)	20,000	40,000	5,000		
7 Original credit (line 1 times line 6)	2,000	4,000	500		
8 Date property ceased to be qualified investment credit property	4-1-84	4-1-84	4-1-84		
9 Number of full years between the date on line 2 and the date on line 8	3 yrs.	2 yrs.	2 yrs.		

Computation of Recapture Tax

	A	B	C	D	E
10 Recapture percentage	40%	60%	60%		
11 Tentative recapture tax—Line 7 times line 10	800	2,400	300		

12 Add line 11, columns A through E	3,500
13 a Enter tax from disposed qualified progress expenditure property (attach separate computation)	
b Enter tax from any part of property ceasing to be at risk (attach separate computation)	
14 Total—Add lines 12, 13a and 13b	3,500
15 Portion of original credit (line 7) not used to offset tax in any year (Do not enter more than line 14—see instructions)	3,500
16 Total increase in tax—Subtract line 15 from line 14. Enter here and on the proper line of your tax return. Do not use this amount to reduce current year's investment credit figured on Form 3468, Computation of Investment Credit. Any unused credit on line 15 cannot be used in any year as a carryback or carryover	0

For Paperwork Reduction Act Notice, see Instructions on back.

Form 4255 (Rev. 11-82)

Form **4797**

Department of the Treasury
Internal Revenue Service

Supplemental Schedule of Gains and Losses

(Includes Gains and Losses From Sales or Exchanges of Assets Used in a Trade or Business and Involuntary Conversions)

▶ To be filed with Forms 1040, 1041, 1065, 1120S, 1120, etc.—See Separate Instructions

OMB No. 1545-0184

1984

27

Name(s) as shown on return: Ben Farmer

Identifying number: 000-00-0000

Part I Sales or Exchanges of Property Used in a Trade or Business, and Involuntary Conversions From Other Than Casualty and Theft—Property Held More Than 1 Year (6 Months If Acquired After 6/22/84) (Except for Certain Livestock)

Note: *Use Form 4684 to report involuntary conversions from casualty and theft.*

Caution: *If you sold property on which you claimed the investment credit, you may be liable for recapture of that credit. See Form 4255 for additional information.*

Note: *If you report a loss below and have amounts invested in the activity for which you are not at risk, you will have to file Form 6198. (See instructions under "Special Rules.")*

a. Description of property	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, plus improvements and expense of sale	g. LOSS (f minus the sum of d and e)	h. GAIN (d plus e minus f)
1 Land (200 acres)	1-1-74	4-1-84	400,000	-	200,000		200,000
Land (40 acres)	1-1-79	4-1-84	80,000	-	70,000		10,000

	g	h
2 Gain, if any, from Form 4684, Section B, line 21		
3 Section 1231 gain from installment sales from Form 6252, line 22 or 30		3,000
4 Gain, if any, on line 28 from other than casualty and theft		
5 Add lines 1 through 4 in column g and column h	( )	213,000
6 Combine columns g and h of line 5. Enter gain or (loss) here, and on the appropriate line as follows:		213,000

(a) For all except partnership returns:

(1) If line 6 is a gain, enter the gain as a long-term capital gain on Schedule D. See specific instructions for Part I.

(2) If line 6 is zero or a loss, enter that amount on line 7. (S corporations, enter on Schedule K (Form 1120S), line 6.)

(b) For partnership returns: Enter each partner's share of line 6 above, on Schedule K-1 (Form 1065), line 7.

Part II Ordinary Gains and Losses

a. Description of property	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, plus improvements and expense of sale	g. LOSS (f minus the sum of d and e)	h. GAIN (d plus e minus f)
7 Loss, if any, from line 6(a)(2)							
8 Gain, if any, on line 27							9,000
9 Net gain or (loss) from Form 4684, Section B, lines 13 and 20(a)							
10 Ordinary gain from installment sales from Form 6252, line 21 or 29 (Applies only to sales before 6/7/84)							
11 Recapture of section 179 deduction (see instructions)							
12 Other ordinary gains and losses (include property held 1 year or less, (6 months or less if acquired after 6/22/84))							
13 Add lines 7 through 12 in column g and column h						( )	9,000

14 Combine columns g and h of line 13. Enter gain or (loss) here, and on the appropriate line as follows:	9,000
(a) For all except individual returns: Enter the gain or (loss) from line 14, on the return being filed. See instructions for Part II for specific line references.	
(b) For individual returns:	
(1) If the loss on line 7 includes a loss from Form 4684, Section B, Part II, column B(ii), enter that part of the loss here and on line 19 of Schedule A (Form 1040). Identify as from "Form 4797, line 14(b)(1)"	
(2) Redetermine the gain or (loss) on line 14, excluding the loss (if any) on line 14(b)(1). Enter here and on Form 1040, line 15	9,000

For Paperwork Reduction Act Notice, see page 1 of separate instructions.

Form 4797 (1984)

[illegible]

[illegible]	[illegible]	[illegible]	[illegible]	
[illegible]	[illegible]	[illegible]	[illegible]	
[illegible]	[illegible]	[illegible]	[illegible]	
[illegible]	[illegible]	[illegible]	[illegible]	
[illegible]	[illegible]	[illegible]	[illegible]	
[illegible]	[illegible]	[illegible]	[illegible]	
[illegible]	[illegible]	[illegible]	[illegible]	
[illegible]	[illegible]	[illegible]	[illegible]	

[illegible]

[illegible]

Form **6251**

Alternative Minimum Tax Computation

[illegible]

PROBLEM 1B: BANKRUPTCY/§1398(d)(2)(A) ELECTION

Assume the same fact pattern set forth in Problem 1A with the exception that Ben Farmer elects to initiate a Chapter 7 bankruptcy proceeding on April 1, 1984, rather than liquidating his entire farm operation by agreement with his local banker. All assets comprising the farm operation are liquidated during the course of bankruptcy by the bankruptcy trustee. (See discussion concerning application of §1398(f)(2) for significance). Liquidation fair market value of these assets is as set forth in Problem 1. Ben makes a §1398(d)(2)(A) election to treat calendar year 1984 as two taxable years for purposes of filing his 1984 individual income tax returns.

First Short Year:
(1-1-84 to 3-31-84)

Taxable Income:		Tax Liab. (Fed. only):	
Sch. F	8,000 *	Regular	
NOL carryover	(8,000)	(annualized)	0
	0	(Self-empl. tax)	904
			904

* For purposes of this problem, presume allowable depreciation from January 1, 1984, to March 31, 1984, has been deducted for eligible farm assets.

TAX ATTRIBUTES PASSING TO BANKRUPTCY TRUSTEE - §1398(g)
4-1-84

Year	Unused NOL Carryover	Unused ITC Carryover	Unused Capital Loss
1981	$ 0	0	0
1982	12,300	6,500	0
1983	15,000	0	1,000
Totals	$27,300	$6,500	$1,000

NOTE: No attributes would pass from bankruptcy estate on termination.

Second Short Year:
(4-1-84 to 12-31-84)

Taxable Income:		Tax Liability (Fed. only):	
W-2	13,000	Regular	
Pers. Exempt.	(1,000)	(annualized)	1,649
	12,000		1,649
Annualized:	17,000		

Total Tax Liability: 2,553
Problems 1B and 2B

SECTION 1398 ELECTION

PROBLEM 18

Form 1040 Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return 1984

For the year January 1–December 31, 1984, or other tax year beginning Jan. 1, 1984, ending March 31, 19 84. OMB No. 1545-0074

Your first name and initial (if joint return, also give spouse's name and initial) Last name Ben Farmer		Your social security number 000 | 00 | 0000
Present home address (Number and street, including apartment number, or rural route) R. R. #1		Spouse's social security number
City, town or post office, State, and ZIP code Algona, IA 50511	Your occupation Farmer Spouse's occupation	

Presidential Election Campaign: Do you want $1 to go to this fund? X Yes ☐ No. If joint return, does your spouse want $1 to go to this fund? ☐ Yes ☐ No. Note: Checking "Yes" will not change your tax or reduce your refund.

For Privacy Act and Paperwork Reduction Act Notice, see Instructions.

Filing Status (Check only one box.)

1 ☒ Single
2 ☐ Married filing joint return (even if only one had income)
3 ☐ Married filing separate return. Enter spouse's social security no. above and full name here
4 ☐ Head of household (with qualifying person). (See page 5 of Instructions.) If the qualifying person is your unmarried child but not your dependent, write child's name here
5 ☐ Qualifying widow(er) with dependent child (Year spouse died ▶ 19). (See page 6 of Instructions.)

Exemptions

6a ☒ Yourself ☐ 65 or over ☐ Blind
b ☐ Spouse ☐ 65 or over ☐ Blind
Enter number of boxes checked on 6a and b ▶ 1
c First names of your dependent children who lived with you
Enter number of children listed on 6c ▶ 0
d Other dependents: (1) Name (2) Relationship (3) Number of months lived in your home (4) Did dependent have income of $1,000 or more? (5) Did you provide more than one-half of dependent's support?
Enter number of other dependents ▶ 0
Add numbers entered in boxes above ▶ 1
e Total number of exemptions claimed (also complete line 36)

Income

7	Wages, salaries, tips, etc.	7	
8	Interest income (also attach Schedule B if over $400)	8	
9a	Dividends (also attach Schedule B if over $400) ___ 9b Exclusion ___		
c	Subtract line 9b from line 9a and enter the result	9c	
10	Refunds of State and local income taxes, from the worksheet on page 9 of Instructions (do not enter an amount unless you deducted those taxes in an earlier year—see page 9)	10	
11	Alimony received	11	
12	Business income or (loss) (attach Schedule C)	12	
13	Capital gain or (loss) (attach Schedule D)	13	
14	40% of capital gain distributions not reported on line 13 (see page 9 of Instructions)	14	
15	Supplemental gains or (losses) (attach Form 4797)	15	
16	Fully taxable pensions, IRA distributions, and annuities not reported on line 17	16	
17a	Other pensions and annuities, including rollovers. Total received 17a		
b	Taxable amount, if any, from the worksheet on page 10 of Instructions	17b	
18	Rents, royalties, partnerships, estates, trusts, etc. (attach Schedule E)	18	
19	Farm income or (loss) (attach Schedule F)	19	8,000
20a	Unemployment compensation (insurance). Total received 20a		
b	Taxable amount, if any, from the worksheet on page 10 of Instructions	20b	
21a	Social security benefits. (see page 11 of Instructions) 21a		
b	Taxable amount, if any, from the worksheet on page 11 of Instructions	21b	
22	Other income (state nature and source—see page 11 of Instructions) NOL Carryover-- 1982 (18,000); 1983 (25,000)	22	(43,000)
23	Add lines 7 through 22. This is your total income ▶	23	(35,000)

Please attach Copy B of your Forms W-2, W-2G, and W-2P here.

If you do not have a W-2, see page 5 of Instructions.

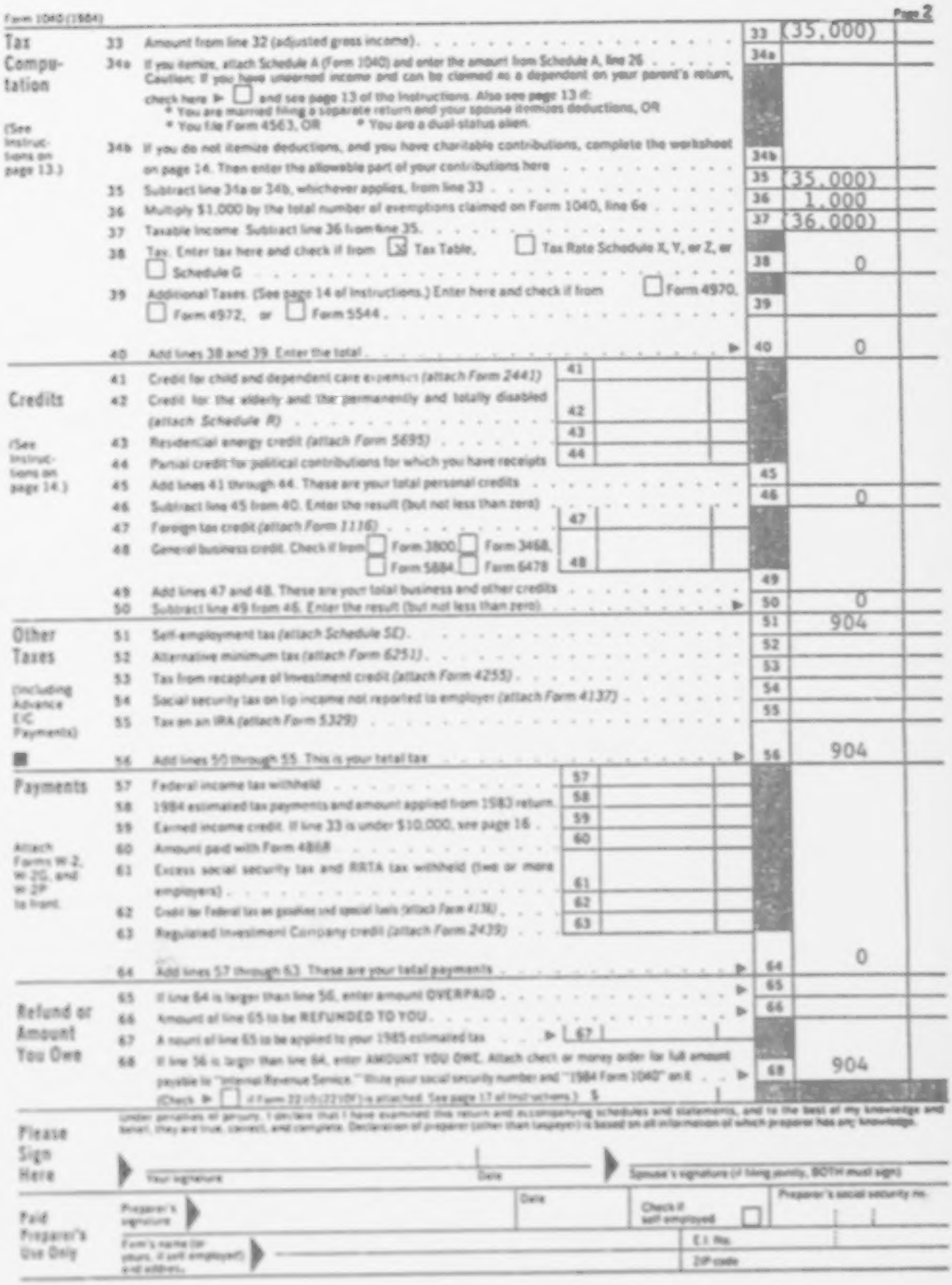
Please attach check or money order here.

Adjustments to Income (See Instructions on page 11.)

24	Moving expense (attach Form 3903 or 3903F)	24	
25	Employee business expenses (attach Form 2106)	25	
26a	IRA deduction, from the worksheet on page 12	26a	
b	Enter here IRA payments you made in 1985 that are included in line 26a above ▶		
27	Payments to a Keogh (H.R. 10) retirement plan	27	
28	Penalty on early withdrawal of savings	28	
29	Alimony paid	29	
30	Deduction for a married couple when both work (attach Schedule W)	30	
31	Add lines 24 through 30. These are your total adjustments ▶	31	0

Adjusted Gross Income

32	Subtract line 31 from line 23. This is your adjusted gross income. If this line is less than $10,000, see "Earned Income Credit" (line 59) on page 16 of Instructions. If you want IRS to figure your tax, see page 3 of Instructions. ▶	32	(35,000)



Form 1040 (1984) Page 2

Tax Computation (See Instructions on page 13.)	33	Amount from line 32 (adjusted gross income)		33 (35,000)
	34a	If you itemize, attach Schedule A (Form 1040) and enter the amount from Schedule A, line 26 Caution: If you have unearned income and can be claimed as a dependent on your parent's return, check here ▶ ☐ and see page 13 of the Instructions. Also see page 13 if: • You are married filing a separate return and your spouse itemizes deductions, OR • You file Form 4563, OR • You are a dual-status alien.		34a
	34b	If you do not itemize deductions, and you have charitable contributions, complete the worksheet on page 14. Then enter the allowable part of your contributions here		34b
	35	Subtract line 34a or 34b, whichever applies, from line 33		35 (35,000)
	36	Multiply $1,000 by the total number of exemptions claimed on Form 1040, line 6e		36 1,000
	37	Taxable Income. Subtract line 36 from line 35.		37 (36,000)
	38	Tax. Enter tax here and check if from ☒ Tax Table, ☐ Tax Rate Schedule X, Y, or Z, or ☐ Schedule G		38 0
	39	Additional Taxes. (See page 14 of Instructions.) Enter here and check if from ☐ Form 4970, ☐ Form 4972, or ☐ Form 5544		39
	40	Add lines 38 and 39. Enter the total ▶		40 0
Credits (See Instructions on page 14.)	41	Credit for child and dependent care expenses (attach Form 2441)	41	
	42	Credit for the elderly and the permanently and totally disabled (attach Schedule R)	42	
	43	Residential energy credit (attach Form 5695)	43	
	44	Partial credit for political contributions for which you have receipts	44	
	45	Add lines 41 through 44. These are your total personal credits		45
	46	Subtract line 45 from 40. Enter the result (but not less than zero)		46 0
	47	Foreign tax credit (attach Form 1116)	47	
	48	General business credit. Check if from ☐ Form 3800, ☐ Form 3468, ☐ Form 5884, ☐ Form 6478	48	
	49	Add lines 47 and 48. These are your total business and other credits		49
	50	Subtract line 49 from 46. Enter the result (but not less than zero) ▶		50 0
Other Taxes (Including Advance EIC Payments)	51	Self-employment tax (attach Schedule SE)		51 904
	52	Alternative minimum tax (attach Form 6251)		52
	53	Tax from recapture of investment credit (attach Form 4255)		53
	54	Social security tax on tip income not reported to employer (attach Form 4137)		54
	55	Tax on an IRA (attach Form 5329)		55
	56	Add lines 50 through 55. This is your total tax ▶		56 904
Payments Attach Forms W-2, W-2G, and W-2P to front.	57	Federal income tax withheld	57	
	58	1984 estimated tax payments and amount applied from 1983 return	58	
	59	Earned income credit. If line 33 is under $10,000, see page 16	59	
	60	Amount paid with Form 4868	60	
	61	Excess social security tax and RRTA tax withheld (two or more employers)	61	
	62	Credit for Federal tax on gasoline and special fuels (attach Form 4136)	62	
	63	Regulated Investment Company credit (attach Form 2439)	63	
	64	Add lines 57 through 63. These are your total payments ▶		64 0
Refund or Amount You Owe	65	If line 64 is larger than line 56, enter amount OVERPAID ▶		65
	66	Amount of line 65 to be REFUNDED TO YOU ▶		66
	67	Amount of line 65 to be applied to your 1985 estimated tax ▶	67	
	68	If line 56 is larger than line 64, enter AMOUNT YOU OWE. Attach check or money order for full amount payable to "Internal Revenue Service." Write your social security number and "1984 Form 1040" on it ▶ (Check ▶ ☐ if Form 2210 (2210F) is attached. See page 17 of Instructions.) $		68 904

Please Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Your signature | Date ▶ Spouse's signature (if filing jointly, BOTH must sign)

Paid Preparer's Use Only

Preparer's signature ▶ | Date | Check if self-employed ☐ | Preparer's social security no.

Firm's name (or yours, if self-employed) and address ▶ | E.I. No. | ZIP code

Taxpayer: Ben Farmer

SSN/TIN: 000-00-0000

Attachment to
Form 1040

ELECTION OF INDIVIDUAL TAXPAYER TO TERMINATE TAXABLE YEAR
UPON COMMENCEMENT OF CHAPTER 7 BANKRUPTCY PROCEEDING
(PURSUANT TO INTERNAL REVENUE CODE §1398(d)(2))

BE HEREBY ADVISED, that the taxpayer(s) have filed for protection under Chapter 7 of Title 11 of the United States Code (bankruptcy liquidation); and hereby elect(s) to close his/her/their tax year effective the day before commencement of said bankruptcy proceeding, the 31st day of March, 1984. It is understood that this election shall act to split the taxpayer's calendar year into two short taxable years pursuant to the provisions of Internal Revenue Code §1398(d)(2)(A). Taxable income for each short tax year shall be computed on an annualized basis under the provisions of Internal Revenue Code §443(b).

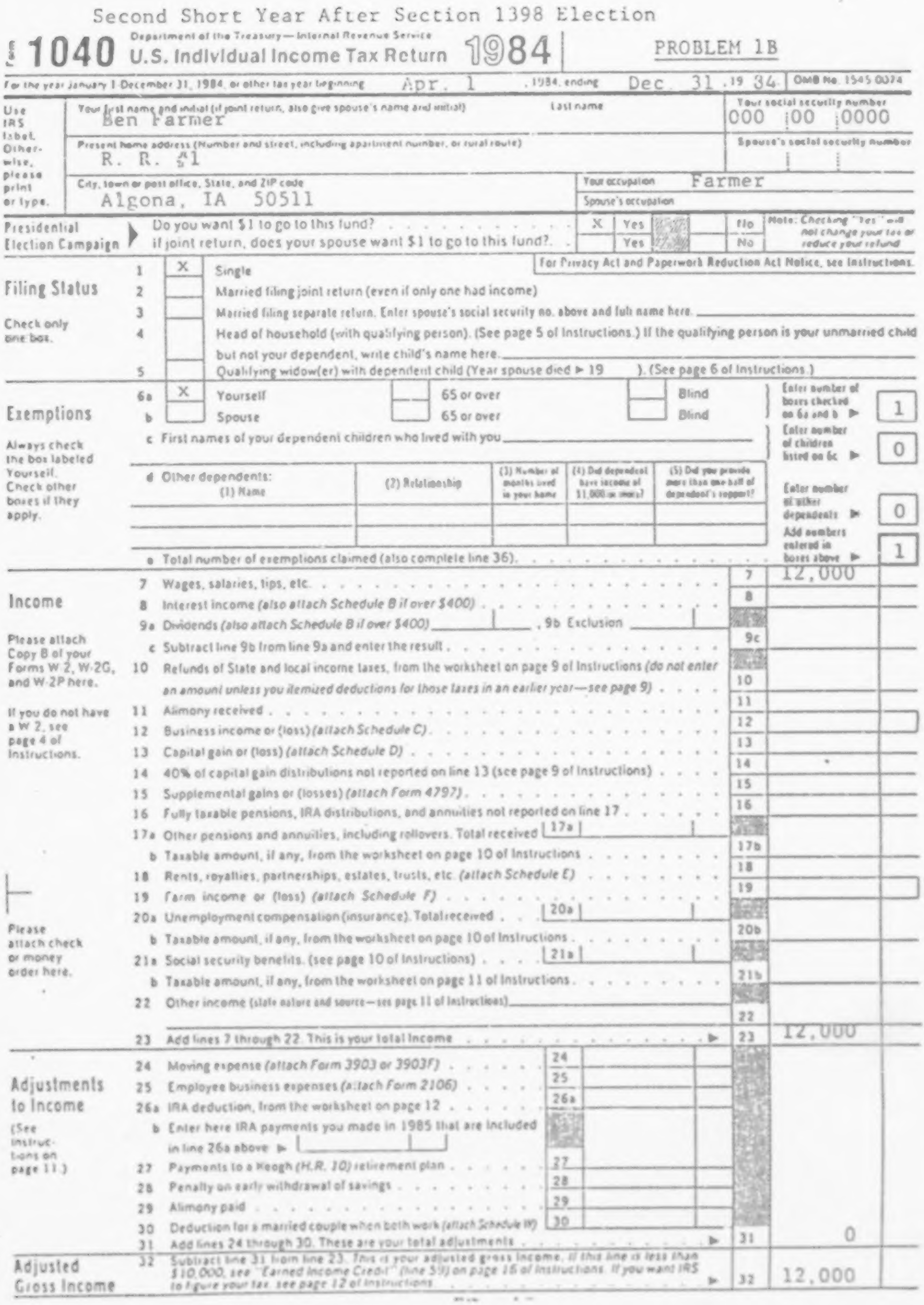
The taxpayer(s) understand(s) that this election, once made, is irrevocable.

axpayer: Ben Farmer

SN: 000-00-0090

Computation of NOL Carryback/Carryover when NOL
is Not Fully Absorbed in Preceding Tax Year(s)
(IRC §172(b)(2); Reg. §1.172-5(a)(2) & (3))

		Tax Year 1984 (1-1-84 to 3-31-84)		19____			Year of NOL 1982 & 1983
et Operating Loss:							$ 18,000 (1982) 25,000 (1983)
nount of Carryback/Carryover:			$ 43,000			$	$43,000
djusted Gross Income (per original return):		$8,000			$		
DD: 1) LTCG deduction (Sch. D).	$			$			
2) Capital losses in excess of capital gains (Sch. D).	____			____			
Total		0			____		
ecomputed Adjusted Gross Income:		$8,000			$		
ESS: 1) Charitable Contributions (Adjust to limit deduction to 50% of the above recomputed AGI).	$			$			
2) Medical Expenses. . . . . General Sales Tax . . . . (Adjust to limit deductions to reflect change in limitations based on above recomputed AGI)							
3) Other Itemized Deductions/ZBA . .	2,300			____			
Total		2,300			____		
ecomputed Taxable Income			5,700			____	
DL Remaining for Carryover			$ 37,300	4-1-84		$	
			(To 1984)	Bankruptcy Estate		(To 19__)	(Revised 11/82)



Second Short Year After Section 1398 Election

Form **1040** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return 1984

PROBLEM 1B

For the year January 1-December 31, 1984, or other tax year beginning Apr. 1, 1984, ending Dec. 31, 19 34. OMB No. 1545-0074

Use IRS label. Otherwise, please print or type.	Your first name and initial (if joint return, also give spouse's name and initial) Last name Ben Farmer	Your social security number 000 00 0000
	Present home address (Number and street, including apartment number, or rural route) R. R. #1	Spouse's social security number
	City, town or post office, State, and ZIP code Algona, IA 50511	Your occupation Farmer Spouse's occupation

Presidential Election Campaign ▶ Do you want $1 to go to this fund? . . . ☒ Yes ☐ No
If joint return, does your spouse want $1 to go to this fund?. . ☐ Yes ☐ No
Note: Checking "Yes" will not change your tax or reduce your refund.

For Privacy Act and Paperwork Reduction Act Notice, see Instructions.

Filing Status

Check only one box.

1 ☒ Single
2 ☐ Married filing joint return (even if only one had income)
3 ☐ Married filing separate return. Enter spouse's social security no. above and full name here. ______
4 ☐ Head of household (with qualifying person). (See page 5 of Instructions.) If the qualifying person is your unmarried child but not your dependent, write child's name here. ______
5 ☐ Qualifying widow(er) with dependent child (Year spouse died ▶ 19). (See page 6 of Instructions.)

Exemptions

Always check the box labeled Yourself. Check other boxes if they apply.

6a ☒ Yourself ☐ 65 or over ☐ Blind
b ☐ Spouse ☐ 65 or over ☐ Blind
Enter number of boxes checked on 6a and b ▶ 1

c First names of your dependent children who lived with you ______
Enter number of children listed on 6c ▶ 0

d Other dependents: (1) Name	(2) Relationship	(3) Number of months lived in your home	(4) Did dependent have income of $1,000 or more?	(5) Did you provide more than one-half of dependent's support?

Enter number of other dependents ▶ 0

e Total number of exemptions claimed (also complete line 36). . . . Add numbers entered in boxes above ▶ 1

Income

Please attach Copy B of your Forms W-2, W-2G, and W-2P here.

If you do not have a W-2, see page 4 of Instructions.

Please attach check or money order here.

7	Wages, salaries, tips, etc.	7	12,000
8	Interest income *(also attach Schedule B if over $400)*	8	
9a	Dividends *(also attach Schedule B if over $400)* ______, 9b Exclusion ______		
c	Subtract line 9b from line 9a and enter the result	9c	
10	Refunds of State and local income taxes, from the worksheet on page 9 of Instructions *(do not enter an amount unless you itemized deductions for those taxes in an earlier year—see page 9)*	10	
11	Alimony received	11	
12	Business income or (loss) *(attach Schedule C)*	12	
13	Capital gain or (loss) *(attach Schedule D)*	13	
14	40% of capital gain distributions not reported on line 13 (see page 9 of Instructions)	14	
15	Supplemental gains or (losses) *(attach Form 4797)*	15	
16	Fully taxable pensions, IRA distributions, and annuities not reported on line 17	16	
17a	Other pensions and annuities, including rollovers. Total received 17a		
b	Taxable amount, if any, from the worksheet on page 10 of Instructions	17b	
18	Rents, royalties, partnerships, estates, trusts, etc. *(attach Schedule E)*	18	
19	Farm income or (loss) *(attach Schedule F)*	19	
20a	Unemployment compensation (insurance). Total received 20a		
b	Taxable amount, if any, from the worksheet on page 10 of Instructions	20b	
21a	Social security benefits. (see page 10 of Instructions) 21a		
b	Taxable amount, if any, from the worksheet on page 11 of Instructions	21b	
22	Other income (state nature and source—see page 11 of Instructions)	22	
23	Add lines 7 through 22. This is your total income ▶	23	12,000

Adjustments to Income

(See Instructions on page 11.)

24	Moving expense *(attach Form 3903 or 3903F)*	24			
25	Employee business expenses *(attach Form 2106)*	25			
26a	IRA deduction, from the worksheet on page 12	26a			
b	Enter here IRA payments you made in 1985 that are included in line 26a above ▶				
27	Payments to a Keogh *(H.R. 10)* retirement plan	27			
28	Penalty on early withdrawal of savings	28			
29	Alimony paid	29			
30	Deduction for a married couple when both work *(attach Schedule W)*	30			
31	Add lines 24 through 30. These are your total adjustments ▶			31	0

Adjusted Gross Income

32	Subtract line 31 from line 23. This is your adjusted gross income. *If this line is less than $10,000, see "Earned Income Credit" (line 59) on page 16 of Instructions. If you want IRS to figure your tax, see page 12 of Instructions* ▶	32	12,000

Form 1040 (1984) Page 2

Tax Computation (See Instructions on page 13.)	33	Amount from line 32 (adjusted gross income)			33	12,000
	34a	If you itemize, attach Schedule A (Form 1040) and enter the amount from Schedule A, line 26 Caution: If you have unearned income and can be claimed as a dependent on your parent's return, check here ▶ ☐ and see page 13 of the Instructions. Also see page 13 if: • You are married filing a separate return and your spouse itemizes deductions, OR • You file Form 4563, OR • You are a dual-status alien.			34a	(income annualized-- see attached schedule)
	34b	If you do not itemize deductions, and you have charitable contributions, complete the worksheet on page 14. Then enter the allowable part of your contributions here			34b	
	35	Subtract line 34a or 34b, whichever applies, from line 33			35	
	36	Multiply $1,000 by the total number of exemptions claimed on Form 1040, line 6e			36	
	37	Taxable Income. Subtract line 36 from line 35.			37	17,300
	38	Tax. Enter tax here and check if from ☐ Tax Table, ☐ Tax Rate Schedule X, Y, or Z, or ☒ Schedule G . (annualized).			38	1,649
	39	Additional Taxes. (See page 14 of Instructions.) Enter here and check if from ☐ Form 4970, ☐ Form 4972, or ☐ Form 5544			39	
	40	Add lines 38 and 39. Enter the total ▶			40	1,649
Credits (See Instructions on page 14.)	41	Credit for child and dependent care expenses *(attach Form 2441)*	41			
	42	Credit for the elderly and the permanently and totally disabled *(attach Schedule R)*	42			
	43	Residential energy credit *(attach Form 5695)*	43			
	44	Partial credit for political contributions for which you have receipts	44			
	45	Add lines 41 through 44. These are your total personal credits			45	0
	46	Subtract line 45 from 40. Enter the result (but not less than zero)			46	1,649
	47	Foreign tax credit *(attach Form 1116)*	47			
	48	General business credit. Check if from ☐ Form 3800, ☐ Form 3468, ☐ Form 5884, ☐ Form 6478	48			
	49	Add lines 47 and 48. These are your total business and other credits			49	0
	50	Subtract line 49 from 46. Enter the result (but not less than zero). ▶			50	1,649
Other Taxes (Including Advance EIC Payments)	51	Self-employment tax *(attach Schedule SE)*			51	
	52	Alternative minimum tax *(attach Form 6251)*			52	
	53	Tax from recapture of investment credit *(attach Form 4255)*			53	
	54	Social security tax on tip income not reported to employer *(attach Form 4137)*			54	
	55	Tax on an IRA *(attach Form 5329)*			55	
	56	Add lines 50 through 55. This is your total tax ▶			56	1,649
Payments Attach Forms W-2, W-2G, and W-2P to front.	57	Federal income tax withheld	57	2,000		
	58	1984 estimated tax payments and amount applied from 1983 return	58			
	59	Earned income credit. If line 33 is under $10,000, see page 16	59			
	60	Amount paid with Form 4868	60			
	61	Excess social security tax and RRTA tax withheld (two or more employers)	61			
	62	Credit for Federal tax on gasoline and special fuels *(attach Form 4136)*	62			
	63	Regulated Investment Company credit *(attach Form 2439)*	63			
	64	Add lines 57 through 63. These are your total payments ▶			64	2,000
Refund or Amount You Owe	65	If line 64 is larger than line 56, enter amount OVERPAID ▶			65	351
	66	Amount of line 65 to be REFUNDED TO YOU ▶			66	351
	67	Amount of line 65 to be applied to your 1985 estimated tax ▶	67			
	68	If line 56 is larger than line 64, enter AMOUNT YOU OWE. Attach check or money order for full amount payable to "Internal Revenue Service." Write your social security number and "1984 Form 1040" on it ▶ (Check ▶ ☐ if Form 2210 (2210F) is attached. See page 17 of Instructions.) $			68	

Please Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature ▶ Date

Spouse's signature (if filing jointly, BOTH must sign) ▶

Paid Preparer's Use Only

Preparer's signature ▶	Date	Check if self-employed ☐	Preparer's social security no.
Firm's name (or yours, if self-employed) and address ▶		E.I. No.	
		ZIP code	

Ben Farmer	Attachment to
SSN: 000-00-0000	Form 1040

CALCULATION OF ANNUALIZED INCOME PURSUANT TO INTERNAL REVENUE CODE §443(b)

Step 1: Modified Taxable Income

a. Adjusted gross income	$ 12,000	
Less: Itemized deductions	-0-	
		$ 12,000
b. LESS: Personal exemptions x $\frac{\text{no. mos. in short yr.}}{12}$		
$ 1,000 x $\frac{9}{12}$ =		$ 750
Modified Taxable Income		$ 11,250

Step 2: Annualized Income

a. Modified tax. income x $\frac{12}{\text{no. mos. in short yr.}}$	
$ 11,250 x $\frac{12}{9}$ =	$ 15,000
b. Add: Zero bracket amount	2,300
Annualized Income	$ 17,300

Step 3: Tax Liability

Tax liab. on annualized inc. x $\frac{\text{no. mos in short yr.}}{12}$	
$ 2,193 x $\frac{9}{12}$ =	$ 1,649

NOTE: The taxpayer must itemize deductions when filing a short tax year return and annualizing income.

NOTE: Self-employment tax is calculated on actual self-employment income.

Schedule G
(Form 1040)
Department of the Treasury
Internal Revenue Service

Income Averaging

▶ See instructions on back. ▶ Attach to Form 1040.

OMB No. 1545 0074
1984
16

Name(s) as shown on Form 1040
Ben Farmer

Your social security number
000 00 0000

Step 1 Add your income from 1981—1983

1981	1	Fill in the amount from your 1981 Form 1040 (line 34) or Form 1040A (line 12). If less than zero, enter zero	1	15,000	
1982	2	Fill in the amount from your 1982 Form 1040 (line 37), Form 1040A (line 16), or Form 1040EZ (line 7). If less than zero, enter zero	2	0	
1983	3	Fill in the amount from your 1983 Form 1040 (line 37), Form 1040A (line 19), or Form 1040EZ (line 7). If less than zero, enter zero	3	0	
Total	4	Fill in all income less deductions earned outside of the U.S. or within U.S. possessions and excluded for 1981 through 1983 (include housing exclusion in 1982 and 1983)	4		
	5	Add lines 1 through 4	5	15,000	

Step 2 Figure your averageable income

6	Divide the amount on line 5 by three (3)	6	5,000	
7	Multiply the amount on line 6 by 140% (1.4)	7	7,000	
8	Fill in your taxable income for 1984 from Form 1040, line 37	8	17,300	*
9	If you received a premature or excessive distribution subject to a penalty under section 72, see instructions	9		
10	Subtract line 9 from line 8	10	17,300	
11	If you live in a community property state and are filing a separate return, see instructions	11		
12	Subtract line 11 from line 10. If less than zero, enter zero	12	17,300	
13	Write in the amount from line 7 above	13	7,000	
14	Subtract line 13 from line 12. This is your averageable income. If this line is $3,000 or less, do not complete the rest of this form	14	10,300	

Step 3 Figure your tax

15	Multiply the amount on line 14 by 25% (.25)			15	2,575
16	Write in the amount from line 7 above			16	7,000
17	Add lines 15 and 16			17	9,575
18	Write in the amount from line 11 above			18	--
19	Add lines 17 and 18			19	9,575
20	Tax on amount on line 19 (from Tax Rate Schedule X, Y, or Z)			20	1,007
21	Tax on amount on line 17 (from Tax Rate Schedule X, Y, or Z)	21	1,007		
22	Tax on amount on line 16 (from Tax Rate Schedule X, Y, or Z)	22	610		
23	Subtract line 22 from line 21	23	397		
24	Multiply the amount on line 23 by 3 *If you have no entry on line 9, skip lines 25 through 27 and go to line 28.*			24	1,191
25	Tax on amount on line 8 (from Tax Rate Schedule X, Y, or Z)	25			
26	Tax on amount on line 10 (from Tax Rate Schedule X, Y, or Z)	26			
27	Subtract line 26 from line 25			27	0
28	Add lines 20, 24, and 27. Write the result here and on Form 1040, line 38 if less than the tax figured using the tax rate schedules or table. Also, check the Schedule G box			28	2,198

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Schedule G (Form 1040) 1984

* Income annualized pursuant to Section 443(b)

Saves 332

PROBLEM 2A: TAX RAMIFICATIONS OF SOLVENCY RESULTING FROM VOLUNTARY TRANSFER

The following will illustrate the tax ramifications that would result if Ben Farmer became solvent to the extent of $20,000 as a result of a voluntary transfer of assets. For purposes of this example, the following will be assumed:

1. Indebtedness on Ben's combine is lowered from $35,000 to $10,000; and
2. All farm real estate is transferred to contract sellers by voluntary deed in lieu of foreclosure on April 1, 1984. All farm equipment is retained by Ben.

Relevant information from Problem 1A, with the above modifications, is set forth below.

Insolvency Calculation:

Asset	Cost	Adj. Basis	Liquidation FMV	Debt
Tractor (acq. 4-1-81)	$ 20,000	$ 10,000	$ 12,000	$ 15,000
Combine (acq. 4-1-82)	40,000	25,000	30,000	10,000
Cultivator (acq. 4-1-82)	5,000	3,000	8,000	5,000
Land - 200A (acq. 1-1-74)	200,000	200,000	400,000	460,000
Land - 40A (acq. 1-1-79)	70,000	70,000	80,000	110,000
TOTALS	$335,000	$308,000	$530,000	$600,000*
Residence (acq. 6-1-73) (exempt property)	15,000	15,000	15,000	-0-
TOTALS	$350,000	$323,000	$545,000	$600,000

*All debt is recourse debt. Principal = $575,000
Interest = $ 25,000 (land only)

Amount of Insolvency: $ 70,000 (25,000 int.)
Discharge of Indebtedness: $ 90,000 (25,000 int.)

Tax Attributes:

Year	Unused NOL Carryover	Unused ITC Carryover	Unused Capital Loss
1981	$ 0	0	0
1982	18,000	4,500	0
1983	25,000	0	1,000
Totals	$43,000	$4,500	$1,000

Transfer of Assets - Tax Consequences:

Asset	§1245 Gain	Capital/ §1250 Gain (Loss)	Potential ITC Recapture	Discharged Indebtedness
Land-100A	0	200,000	0	60,000
Land-40A	0	10,000	0	30,000
TOTALS	$ 0	$210,000	$ 0	$90,000

1984 Income (Without Transfers in Satisfaction of Debt):

Schedule F (Net):	1-1-84 to 4-1-84	$ 8,000
W-2 (Fed. WH = $2,000):	4-1-84 to 12-31-84	12,000

TAX ATTRIBUTES
12-31-84

Discharged Indebtedness (Principal only) - §108(e)(2) (limited to extent of insolvency)	$45,000
NOL Carryovers - §108(b)(2)(A)	-0-
Investment Tax Credit Carryovers - §108(b)(2)(B)(i) ($4,500 x 2)	9,000 *
Capital Loss Carryover - §108(b)(2)(C)	-0-
Basis Reduction of Assets - §108(b)(2)(D) and §1017 (limited to adjusted basis less liabilities on remaining non-exempt property)	8,000
Remaining Discharged Indebtedness (excluded from taxation)	$28,000

NOTE: All other tax attributes were utilized against regular tax liability per IRC §108(b)(4)(A), in the same manner as set forth in Problem 1A.

* Remaining investment tax credit carryover ($4,500) resulting from application of alternative minimum tax. §55(c)(3).

Problem 2A

Form 1040 U.S. Individual Income Tax Return 1984

Ben Farmer 000 00 0000

R. R. 1

Algona, Ia. 50511

Presidential Election Campaign ☒ Yes

Filing Status

1	X	Single
2		Married filing joint return (even if only one had income)
3		Married filing separate return
4		Head of household (with qualifying person)
5		Qualifying widow(er) with dependent child

Exemptions

6a	X	Yourself	1
b		Spouse	0
c		First names of your dependent children who lived with you	0
d		Other dependents	0
e		Total number of exemptions claimed	1

Income

7	Wages, salaries, tips, etc.	12,000
8	Interest income	
9a	Dividends	
10	Refunds of State and local income taxes	
11	Alimony received	
12	Business income or (loss) (attach Schedule C)	
13	Capital gain or (loss) (attach Schedule D) (213,000-1,000) x 40%	84,800
14	40% of capital gain distributions not reported on line 13	
15	Supplemental gains or (losses) (attach Form 4797)	
16	Fully taxable pensions, IRA distributions, and annuities not reported on line 17	
17a	Other pensions and annuities, including rollovers. Total received	
b	Taxable amount, if any	
18	Rents, royalties, partnerships, estates, trusts, etc. (attach Schedule E)	2,000
19	Farm income or (loss) (attach Schedule F)	
20a	Unemployment compensation (insurance). Total received	
b	Taxable amount, if any	
21a	Social security benefits	
b	Taxable amount, if any	
22	Other income NOL carryover	[illegible]
	Discharge of indebtedness, See Form 982	21,000
23	Add lines 7 through 22. This is your total income	[illegible]

Adjustments to Income

24	Moving expense (attach Form 3903 or 3903F)
25	Employee business expenses (attach Form 2106)
26a	IRA deduction
b	Enter here IRA payments you made in 1985 that are included in line 26a above
27	Payments to a Keogh (H.R. 10) retirement plan
28	Penalty on early withdrawal of savings
29	Alimony paid
30	Deduction for a married couple when both work
31	Add lines 24 through 30. These are your total adjustments

[illegible]

Tax Computation

[illegible]

Credits

[illegible]

Other Taxes

[illegible]

Payments

[illegible]

Refund or Amount You Owe

[illegible]

Please Sign Here

[illegible]

Paid Preparer's Use Only

[illegible]

[illegible]

[illegible]

[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
			[illegible]

[illegible]

[illegible]

PROBLEM 2B: TAX RAMIFICATIONS OF SOLVENCY RESULTING FROM VOLUNTARY TRANSFER - §108(b)(5) ELECTION

Assuming the same facts as set forth in Problem 2A above, this Problem will illustrate the tax ramifications that would result if Ben Farmer had elected to reduce the basis of "depreciable" property under §108(b)(5).

NOTE: Reduction of tax attributes is as set forth for Problem 2A above.

Tax Liability Problem 2A:	$36,104
Less: Tax Liability Problem 2B:	30,104
Tax Savings (§108(b)(5) election)	$ 6,000

Problem 2B

FEDERAL TAX GUIDE REPORTS Vol. 68, Part II of Report No. 4, Oct. 26, 1984

Form 1040 Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return 1984

For the year January 1-December 31, 1984, or other tax year beginning , 1984, ending , 19 . OMB No. 1545-0074

Use IRS label. Otherwise, please print or type.

Your first name and initial (if joint return, also give spouse's name and initial) Last name: Ben Farmer

Your social security number: 000 00 0000

Present home address (Number and street, including apartment number, or rural route): R. R. 1

Spouse's social security number:

City, town or post office, State, and ZIP code: Algona, IA 50511

Your occupation:

Spouse's occupation:

Presidential Election Campaign ▶ Do you want $1 to go to this fund? X Yes ☐ No

If joint return, does your spouse want $1 to go to this fund? ☐ Yes ☐ No

Note: *Checking "Yes" will not change your tax or reduce your refund.*

For Privacy Act and Paperwork Reduction Act Notice, see Instructions.

Filing Status

Check only one box.

1 ☒ Single
2 ☐ Married filing joint return (even if only one had income)
3 ☐ Married filing separate return. Enter spouse's social security no. above and full name here.
4 ☐ Head of household (with qualifying person). (See page 5 of Instructions.) If the qualifying person is your unmarried child but not your dependent, write child's name here.
5 ☐ Qualifying widow(er) with dependent child (Year spouse died ▶ 19). (See page 6 of Instructions.)

Exemptions

Always check the box labeled Yourself. Check other boxes if they apply.

6a ☒ Yourself ☐ 65 or over ☐ Blind
b ☐ Spouse ☐ 65 or over ☐ Blind
Enter number of boxes checked on 6a and b ▶ 1

c First names of your dependent children who lived with you
Enter number of children listed on 6c ▶ 0

d Other dependents:

(1) Name	(2) Relationship	(3) Number of months lived in your home	(4) Did dependent have income of $1,000 or more?	(5) Did you provide more than one-half of dependent's support?

Enter number of other dependents ▶ 0

e Total number of exemptions claimed (also complete line 36). Add numbers entered in boxes above ▶ 1

Income

Please attach Copy B of your Forms W-2, W-2G, and W-2P here.

If you do not have a W-2, see page 4 of Instructions.

Please attach check or money order here.

7	Wages, salaries, tips, etc.	7	12,000
8	Interest income *(also attach Schedule B if over $400)*	8	
9a	Dividends *(also attach Schedule B if over $400)* , 9b Exclusion		
c	Subtract line 9b from line 9a and enter the result	9c	
10	Refunds of State and local income taxes, from the worksheet on page 9 of Instructions *(do not enter an amount unless you itemized deductions for those taxes in an earlier year—see page 9)*	10	
11	Alimony received	11	
12	Business income or (loss) *(attach Schedule C)*	12	
13	Capital gain or (loss) *(attach Schedule D)* (210,000 - 1,000) x .40%	13	83,600
14	40% of capital gain distributions not reported on line 13 (see page 9 of Instructions)	14	
15	Supplemental gains or (losses) *(attach Form 4797)*	15	
16	Fully taxable pensions, IRA distributions, and annuities not reported on line 17	16	
17a	Other pensions and annuities, including rollovers. Total received 17a		
b	Taxable amount, if any, from the worksheet on page 10 of Instructions	17b	
18	Rents, royalties, partnerships, estates, trusts, etc. *(attach Schedule E)*	18	
19	Farm income or (loss) *(attach Schedule F)*	19	8,000
20a	Unemployment compensation (insurance). Total received 20a		
b	Taxable amount, if any, from the worksheet on page 10 of Instructions	20b	
21a	Social security benefits. (see page 10 of Instructions) 21a		
b	Taxable amount, if any, from the worksheet on page 11 of Instructions	21b	
22	Other income (state nature and source—see page 11 of Instructions) NOL carryover 1982 (18,000); 1983 (25,000)	22	(43,000)
23	Add lines 7 through 22. This is your total income ▶	23	60,600

Adjustments to Income

(See Instructions on page 11.)

24	Moving expense *(attach Form 3903 or 3903F)*	24			
25	Employee business expenses *(attach Form 2106)*	25			
26a	IRA deduction, from the worksheet on page 12	26a			
b	Enter here IRA payments you made in 1985 that are included in line 26a above ▶				
27	Payments to a Keogh *(H.R. 10)* retirement plan	27			
28	Penalty on early withdrawal of savings	28			
29	Alimony paid	29			
30	Deduction for a married couple when both work *(attach Schedule W)*	30			
31	Add lines 24 through 30. These are your total adjustments ▶			31	0

Adjusted

32 Subtract line 31 from line 23. *This is your* **adjusted gross income.** *If this line is less than*

Form 1040 (1984) **Page 2**

Tax Computation (See Instructions on page 13.)	33	Amount from line 32 (adjusted gross income)			33	60,600
	34a	If you itemize, attach Schedule A (Form 1040) and enter the amount from Schedule A, line 26 Caution: If you have unearned income and can be claimed as a dependent on your parent's return, check here ▶ ☐ and see page 13 of the Instructions. Also see page 13 if: • You are married filing a separate return and your spouse itemizes deductions, OR • You file Form 4563, OR • You are a dual-status alien.			34a	
	34b	If you do not itemize deductions, and you have charitable contributions, complete the worksheet on page 14. Then enter the allowable part of your contributions here			34b	
	35	Subtract line 34a or 34b, whichever applies, from line 33			35	60,000
	36	Multiply $1,000 by the total number of exemptions claimed on Form 1040, line 6e			36	1,000
	37	Taxable Income. Subtract line 36 from line 35			37	59,600
	38	Tax. Enter tax here and check if from ☐ Tax Table, ☐ Tax Rate Schedule X, Y, or Z, or ☒ Schedule G			38	11,146
	39	Additional Taxes. (See page 14 of Instructions.) Enter here and check if from ☐ Form 4970, ☐ Form 4972, or ☐ Form 5544			39	
	40	Add lines 38 and 39. Enter the total ▶			40	11,146
Credits (See Instructions on page 14.)	41	Credit for child and dependent care expenses *(attach Form 2441)*	41			
	42	Credit for the elderly and the permanently and totally disabled *(attach Schedule R)*	42			
	43	Residential energy credit *(attach Form 5695)*	43			
	44	Partial credit for political contributions for which you have receipts	44			
	45	Add lines 41 through 44. These are your total personal credits			45	0
	46	Subtract line 45 from 40. Enter the result (but not less than zero)			46	11,146
	47	Foreign tax credit *(attach Form 1116)*	47			
	48	General business credit. Check if from ☐ Form 3800, ☒ Form 3468, ☐ Form 5884, ☐ Form 6478	48	4,500		
	49	Add lines 47 and 48. These are your total business and other credits			49	4,500
	50	Subtract line 49 from 46. Enter the result (but not less than zero) ▶			50	6,646
Other Taxes (Including Advance EIC Payments)	51	Self-employment tax *(attach Schedule SE)*			51	904
	52	Alternative minimum tax *(attach Form 6251)*			52	24,554
	53	Tax from recapture of investment credit *(attach Form 4255)*			53	
	54	Social security tax on tip income not reported to employer *(attach Form 4137)*			54	
	55	Tax on an IRA *(attach Form 5329)*			55	
	56	Add lines 50 through 55. This is your **total tax** ▶			56	32,104
Payments Attach Forms W-2, W-2G, and W-2P to front.	57	Federal income tax withheld	57	2,000		
	58	1984 estimated tax payments and amount applied from 1983 return	58			
	59	Earned income credit. If line 33 is under $10,000, see page 16	59			
	60	Amount paid with Form 4868	60			
	61	Excess social security tax and RRTA tax withheld (two or more employers)	61			
	62	Credit for Federal tax on gasoline and special fuels *(attach Form 4136)*	62			
	63	Regulated Investment Company credit *(attach Form 2439)*	63			
	64	Add lines 57 through 63. These are your **total payments** ▶			64	2,000
Refund or Amount You Owe	65	If line 64 is larger than line 56, enter amount **OVERPAID** ▶			65	
	66	Amount of line 65 to be **REFUNDED TO YOU** ▶			66	
	67	Amount of line 65 to be applied to your 1985 estimated tax ▶	67			
	68	If line 56 is larger than line 64, enter **AMOUNT YOU OWE**. Attach check or money order for full amount payable to "Internal Revenue Service." Write your social security number and "1984 Form 1040" on it ▶ (Check ▶ ☐ if Form 2210 (2210F) is attached. See page 17 of Instructions.) $			68	30,104

Please Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Your signature ____ Date ____ ▶ Spouse's signature (if filing jointly, BOTH must sign) ____

Paid Preparer's Use Only

Preparer's signature ▶	Date	Check if self-employed ☐	Preparer's social security no.
Firm's name (or yours, if self-employed) and address ▶		E.I. No.	
		ZIP code	

[illegible]

Form **982**
(Rev. Dec [illegible])
Department of the Treasury
Internal Revenue Service

Adjustment of Basis of Property Under Sections 1017 or 1082(a)(2) of the Internal Revenue Code

▶ Attach this form to your income tax return.

OMB No. [illegible]
Expires [illegible]

Name: Ben Farmer
Identifying number: 000-00-0000
Number and street: R. R. #1
City or town, State, and ZIP code: Algona, IA 50511

Part I Adjustment of Basis of Property Under Section 1017

Taxable year in which amount was excluded beginning Jan. 1, 19 84 ending December 31, 19 84

1 Enter amount excluded from gross income as qualified business indebtedness under section 108(a)(1)(C) and (d)(4) . . . -0-

2 Enter amount excluded from gross income which the taxpayer elects to apply first to reduce the basis of depreciable property under section 108(b)(5) . . . 20,000

3 Do you elect to treat all real property described in section 1221(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? . . . ☐ Yes ☒ No N/A

4 Description of property	Basis before reduction	Basis after reduction	Reduction
Tractor	10,000	4,737	5,263
Combine	25,000	11,842	13,158
Cultivator	3,000	1,421	1,579
Total . . .			20,000

5 Narrative statement of the transactions resulting in discharge of indebtedness and nature of the discharge. Include date of discharge, amounts of discharge, and whether taxpayer was solvent, insolvent, or in a title 11 case (as defined in section 108(d)(2)) at time of discharge.

SEE ATTACHED SCHEDULE (Narrative excluded)

Part II Consent of Corporation to Adjustment of Basis of its Property Under Section 1082(a)(2) of the Internal Revenue Code

The corporation named above has excluded under section 1081(b) of the Internal Revenue Code $..............................

from its gross income for the tax year beginning ...., and ending ....
Under that section the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) of the Internal Revenue Code in effect at the time of filing its income tax return for that year. The corporation is

organized under the laws of ....
(State of incorporation)

Note: You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.

SIGNATURE

Under penalties of perjury I declare that I have examined this form including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete.

.... Signature of individual taxpayer .... Date

.... Signature of corporate taxpayer .... Title .... Date

For Paperwork Reduction Act Notice, see back of form.

II

99th CONGRESS
1st Session

S. 418

To amend the Internal Revenue Code of 1954 to exclude certain net capital gain of insolvent taxpayers from the alternative minimum tax.

IN THE SENATE OF THE UNITED STATES

February 6 (legislative day, January 21), 1985

Mr. Grassley (for himself, Mr. Armstrong, and Mr. Durenberger) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to exclude certain net capital gain of insolvent taxpayers from the alternative minimum tax.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. CERTAIN NET CAPITAL GAIN OF INSOLVENT TAXPAYERS EXCLUDED FROM ALTERNATIVE MINIMUM TAX.

(a) In General.—Paragraph (9) of section 57(a) of the Internal Revenue Code of 1954 (relating to items of preference) is amended by adding at the end thereof the following new subparagraph:

"(E) Insolvent taxpayers.—For purposes of subparagraph (A), gain or loss from the transfer of property to a creditor in cancellation of a debt or from the sale or exchange of property under threat of foreclosure shall not be taken into account in computing net capital gain if, immediately before such transfer or sale or exchange, the taxpayer is insolvent (as defined in section 108(d)(3)).".

(b) Effective Date.—The amendment made by this section shall apply to transfers or sales or exchanges made after December 31, 1981, in taxable years ending after such date.

○

99TH CONGRESS
1ST SESSION

H. R. 2277

To amend the Internal Revenue Code of 1954 to provide an exemption from the minimum tax for capital gains on sales of farm property by insolvent farmers.

IN THE HOUSE OF REPRESENTATIVES

APRIL 30, 1985

Mr. LIGHTFOOT introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To amend the Internal Revenue Code of 1954 to provide an exemption from the minimum tax for capital gains on sales of farm property by insolvent farmers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. EXEMPTION FROM MINIMUM TAX FOR CAPITAL GAINS ON SALES OF FARM PROPERTY BY INSOLVENT FARMERS.

(a) GENERAL RULE.—Paragraph (9) of section 57(a) of the Internal Revenue Code of 1954 (relating to capital gains) is amended by adding at the end thereof the following new subparagraph:

"(E) SALES OF FARM PROPERTY BY INSOLVENT FARMERS.—For purposes of this paragraph, gain from a qualified farm sale (as defined in subsection (f)) shall not be taken into account."

(b) QUALIFIED FARM SALE DEFINED.—Section 57 of such Code is amended by adding at the end thereof the following new subsection:

"(f) QUALIFIED FARM SALE.—

"(1) IN GENERAL.—For purposes of subsection (a)(9)(E), the term 'qualified farm sale' means any sale or exchange to an unrelated person of farm property during any taxable year if—

"(A) 50 percent or more of the gross income of the taxpayer for the taxable year is attributable to the trade or business of farming, "(B) such taxpayer is insolvent (within the meaning of section 108(d)(3)) as of the time of the sale or exchange,

"(C) substantially all of the proceeds from the sale or exchange are applied in satisfaction of indebtedness of the taxpayer, and

"(D) 90 percent or more of the fair market value of the farm property held by the taxpayer as of the beginning of such taxable year is sold or exchanged during such taxable year in qualified farm sales (determined without regard to this subparagraph).

"(2) DEFINITIONS.—For purposes of this subsection—

"(A) FARM PROPERTY.—The term 'farm property' means any property used or held for use in the trade or business of farming.

"(B) UNRELATED PERSON.—The term 'unrelated person' means any person other than a related person (as defined in section 453(f)(1))."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1985.

○

IA-6251
41-131

IOWA ALTERNATIVE MINIMUM TAX WORKSHEET

For Individuals, Estates and Trusts

1. Federal alternative minimum tax per return (from line 12 Federal Form 6251) .... 1.

2. Federal alternative minimum taxable income (from line 5 Federal Form 6251) .... 2.

3. Exemption Amount (from line 6 Federal Form 6251) .... 3.

4. Tax preference items: (from lines 4a through 4k of Federal Form 6251)

   a. Dividend exclusion 4.a

   b. 60% capital gain deduction 4.b

   c. Accelerated depreciation on nonrecovery real property or 15 (or 18)-year real property 4.c

   d. Accelerated depreciation on leased personal property or leased recovery property other than 15 (or 18)-year real property 4.d

   e. Amortization of certified pollution control facilities 4.e

   f. Mining exploration and development costs 4.f

   g. Circulation and research and experimental expenditures 4.g

   h. Reserves for losses on bad debts of financial institutions 4.h

   i. Depletion 4.i

   j. Incentive stock options 4.j

   k. Intangible drilling costs 4.k

5. Total Preferences (add lines 4a through 4k) .... 5.

6. Total Exemption plus Preferences (line 3 plus line 5) .... 6.

7. Alternative Income Net of Exemption and Preference (line 2 less line 6) .... 7.

8. Gross alternative minimum tax without preference items (multiply line 7 by .20) .... 8.

9. Regular federal tax after all credits (from line 50 Federal Form 1040 or line 30 Federal Form 1041) .... 9.

10. Net Tax (line 8 less line 9 but not less than zero) .... 10.

11. Federal alternative minimum tax attributable to preference items (line 1 less line 10) .... 11.

12. IOWA ALTERNATIVE MINIMUM TAX (multiply line 11 by .70 and enter total on line 12 of IA 1040 or line 26 of IA 1041) .... 12.

CPE-66345

SENATE FILE 24

AN ACT

TO IMPOSE A STATE ALTERNATIVE MINIMUM TAX TO REPLACE THE STATE MINIMUM TAX UNDER THE INDIVIDUAL INCOME TAX AND MAKING THE ACT RETROACTIVE.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:

Section 1. Section 422.5, Code 1985, is amended by adding the following new subsection:

NEW SUBSECTION. 15. There is imposed upon every resident and nonresident of this state, including estates and trusts, the greater of the tax determined in subsections 1 through 14 or the state alternative minimum tax equal to nine percent of the state alternative minimum taxable income of the taxpayer as computed under this subsection.

The state alternative minimum taxable income of a taxpayer is equal to the taxpayer's state taxable income, as computed with the deductions in section 422.9, with the following adjustments:

a. Add items of tax preference included in federal alternative minimum taxable income under section 57 of the Internal Revenue Code of 1954. In the case of an estate or trust, the items of tax preference shall be apportioned between the estate or trust and the beneficiaries in accordance with rules prescribed by the director. For purposes of computing the items of tax preference, the gain or loss from the forfeiture of an installment real estate contract, the transfer of real or personal property securing a debt to a creditor in cancellation of that debt or from the sale or exchange of property as a result of actual notice of foreclosure shall not be taken into account in computing net capital gain if all of the following conditions are met:

(1) The forfeiture, transfer, or sale or exchange was done for the purpose of establishing a positive cash flow.

(2) Immediately before the forfeiture, transfer, or sale or exchange, the taxpayer's debt to asset ratio exceeded seventy-five percent as computed under generally accepted accounting practices.

(3) The taxpayer's net worth at the end of the tax year is less than seventy-five thousand dollars.

In determining a taxpayer's net worth at the end of the tax year a taxpayer shall include any asset transferred within one hundred twenty days prior to the end of the tax year without adequate and full consideration in money or money's worth. In determining the taxpayer's debt to asset ratio, the taxpayer shall include any asset transferred, within one hundred twenty days prior to such forfeiture, transfer, or sale or exchange, without adequate and full consideration in money or money's worth. For purposes of this subsection, actual notice of foreclosure includes, but is not limited to, bankruptcy or written notice from a creditor of the creditor's intent to foreclose where there is reasonable belief that the creditor can force a sale of the property.

b. Subtract the applicable exemption amount as follows:

(1) Seventeen thousand five hundred dollars for a married person who files separately or for an estate or trust.

(2) Twenty-six thousand dollars for a single person or an unmarried head of household.

(3) Thirty-five thousand dollars for a married couple which files a joint return.

c. Subtract the amount of the net operating loss computed in section 422.9, subsection 3, for a tax year other than the current year which was carried back or carried forward to the current year under section 422.9, subsection 3, paragraph "a", "b" or "c". However, in the case of a net operating loss computed for a tax year beginning after December 31, 1982 which is carried back or carried forward to the current taxable year, the net operating loss shall be reduced by the amount of the items of tax preference arising in such year which was taken into account in computing the net operating loss in section 422.9, subsection 3.

The state alternative minimum tax of a taxpayer whose items of tax preference include the gain or loss from the forfeiture of an installment real estate contract, the transfer of real or personal property securing a debt to a creditor in cancellation of that debt or from the sale or exchange of property as a result of actual notice of foreclosure where the fair market value of the taxpayer's assets exceeds the taxpayer's liabilities immediately before such forfeiture, transfer, or sale or exchange shall not be greater than such excess, including any asset transferred within one hundred twenty days prior to such forfeiture, transfer, or sale or exchange.

In the case of a resident, including a resident estate or trust, the state's apportioned share of the state alternative minimum tax is one hundred percent of the state alternative minimum tax computed in this subsection. In the case of a nonresident, including a nonresident estate or trust, or an individual, estate or trust that is domiciled in the state for less than the entire tax year, the state's apportioned share of the state alternative minimum tax is the amount of tax computed under this subsection, reduced by the applicable credits in sections 422.10, 422.11, 422.11A as enacted by 1985 Iowa Acts, Senate File 395, section 80 and 422.12 and this result multiplied by a fraction with a numerator of the sum of state net income allocated to Iowa as determined in section 422.8, subsection 2, and tax preference items attributable to Iowa and with a denominator of the sum of total net income computed under section 422.7 and all tax preference items. In computing this fraction, those items excludable under paragraph "a" shall not be used in computing the tax preference items. Married taxpayers electing to file separate returns or separately on a combined return must allocate the minimum tax computed in this subsection in the proportion that each spouse's respective preference items under section 57 of the Internal Revenue Code of 1954 bear to the combined preference items of both spouses.

Sec. 2. Section 422.5, Code 1985, is amended by striking unnumbered paragraph 10.

Sec. 3. Section 422.8, Code 1985, is amended by adding the following new subsection:

NEW SUBSECTION. 4. The amount of minimum tax paid to another state or foreign country by a resident taxpayer of this state from preference items derived from sources outside of Iowa shall be allowed as a credit against the tax computed under this division except that the credit shall not exceed what the amount of state alternative minimum tax would have been on the same preference items which were taxed by the other state or foreign country. The limitation on this credit shall be computed according to the following formula: The total of preference items earned outside of Iowa and taxed by another state or foreign country shall be divided by the total of preference items of the resident taxpayer of Iowa. In computing this quotient, those items excludable under section 422.5, subsection 15, paragraph "a" shall not be used in computing the preference items. This quotient multiplied times the net state alternative minimum tax as determined in section 422.5, subsection 15, on the total of preference items as if entirely earned in Iowa shall be the maximum tax credit against the Iowa alternative minimum tax. However, the maximum tax credit will not be allowed to the extent that the minimum tax imposed by the other state or foreign country is less than the maximum tax credit computed above.

Sec. 4. In computing the items of tax preference for purposes of the Iowa minimum tax for a tax year beginning in the 1984 calendar year, the gain or loss from the forfeiture of an installment real estate contract, the transfer of property to a creditor in cancellation of a debt or from the sale or exchange of property as a result of actual notice of foreclosure shall not be taken into account in computing net capital gain if, immediately before such forfeiture, transfer, or sale or exchange, the taxpayer's liabilities exceed the fair market value of the taxpayer's assets and the taxpayer's net worth at the end of the tax year is less than one hundred thousand dollars. For purposes of this section, actual notice of foreclosure includes, but is not limited to, bankruptcy or written notice from a creditor of the creditor's intent to foreclose where there is reasonable belief that the creditor can force a sale of the property. In computing the Iowa minimum tax for a tax year beginning in the 1984 calendar year, the Iowa minimum tax of a taxpayer whose items of tax preference include the gain or loss from the forfeiture of an installment real estate contract, the transfer of property to a creditor in cancellation of a debt or from the sale or exchange of property as a result of actual notice of foreclosure where the fair market value of the taxpayer's assets exceeds the taxpayer's liabilities immediately before such forfeiture, transfer, or sale or exchange shall not be greater than such excess. A taxpayer who has filed a state return for such tax year may file an amended state return for such tax year with the state minimum tax calculated on the basis of what the federal minimum tax would have been if such items had not been included in the federal minimum tax calculation of net capital gain or with the state minimum tax calculated on the basis of such limitation on the amount of state minimum tax.

Sec. 5. 1985 Iowa Acts, Senate File 395, section 102 is retroactive to January 1, 1985.

Sec. 6. Except for sections 4 and 5, this Act is retroactive to January 1, 1985 for tax years beginning on or after that date. Section 4 of this Act is retroactive to January 1, 1984 for tax years beginning on or after January 1, 1984 and beginning before January 1, 1985. For taxpayers with capital gains transactions occurring between January 1, 1985 and May 1, 1985, the 1985 Iowa minimum tax may be computed under the law in effect on December 31, 1984.

ROBERT T. ANDERSON
President of the Senate

DONALD D. AVENSON
Speaker of the House

I hereby certify that this bill originated in the Senate and is known as Senate File 24, Seventy-first General Assembly.

K. MARIE THAYER
Secretary of the Senate

Approved _____________, 1985

TERRY E. BRANSTAD
Governor

166 7-82

Form **982**
(Rev. Dec. 1981)
Department of the Treasury
Internal Revenue Service

Adjustment of Basis of Property Under Sections 1017 or 1082(a)(2) of the Internal Revenue Code

➤ Attach this form to your income tax return.

OMB No. 1545-0046
Expires 11-30-84

Name | Identifying number

Number and street

City or town, State, and ZIP code

Part I Adjustment of Basis of Property Under Section 1017

Taxable year in which amount was excluded beginning ______, 19__ ending ______, 19__

1 Enter amount excluded from gross income as qualified business indebtedness under section 108(a)(1)(C) and (d)(4) . . ______

2 Enter amount excluded from gross income which the taxpayer elects to apply first to reduce the basis of depreciable property under section 108(b)(5) . . . . ______

3 Do you elect to treat all real property described in section 1221(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? . . . . ☐ Yes ☐ No

4 Description of property	Basis before reduction	Basis after reduction	Reduction
Total			

5 Narrative statement of the transactions resulting in discharge of indebtedness and nature of the discharge. Include date of discharge, amounts of discharge, and whether taxpayer was solvent, insolvent, or in a title 11 case (as defined in section 108(d)(2)) at time of discharge.

Part II Consent of Corporation to Adjustment of Basis of its Property Under Section 1082(a)(2) of the Internal Revenue Code

The corporation named above has excluded under section 1081(b) of the Internal Revenue Code $..........

from its gross income for the tax year beginning ...., and ending ....

Under that section the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) of the Internal Revenue Code in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of .... (State of incorporation).

Note: You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.

SIGNATURE

Under penalties of perjury I declare that I have examined this form including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete.

.... Signature—If individual taxpayer .... Date

.... Signature—If corporate taxpayer .... Title .... Date

For Paperwork Reduction Act Notice, see back of form.

General Instructions

(References are to the Internal Revenue Code)

Paperwork Reduction Act Notice.—The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it, and whether you have to give it to us. We ask for the information to carry out the Internal Revenue laws of the United States. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

A. Purpose of Form.—Form 982 is used to report reductions in basis of property in connection with a discharge of indebtedness.

Part I of Form 982 must be filed by every taxpayer who excludes from gross income under section 108 any amount of income attributable to the discharge of indebtedness, in whole or in part, in the tax year.

Part II of Form 982 is to be used by a corporation excluding from gross income under section 1081(b) any amounts of income attributable to the transfer of property described in that section.

B. Time and place for filing.—Form 982 must be attached to the taxpayer's income tax return for the tax year in which the discharge of indebtedness was obtained (Part I) or the transfer of property occurred (Part II). However, if the taxpayer establishes reasonable cause for not filing this form with the original return, the taxpayer may file this form with an amended return or claim for credit or refund.

C. Identifying number.—Individuals should enter their social security number; all others should enter their employer identification number.

D. Signature.—Form 982 must be signed by the taxpayer. If the taxpayer is a corporation, this form must be signed either by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or by any other corporate officer (such as tax officer) who is authorized to sign. A receiver, trustee, or assignee must sign any form that is required to be filed on behalf of a corporation.

Specific Instructions

Part I

Line 1.—The amount of qualified business indebtedness under section 108(a)(1)(C) and (d)(4) applies to indebtedness which was incurred or assumed either (1) by a corporation, or (2) by an individual in connection with property used in the individual's trade or business; and for which indebtedness the corporation or individual is liable, or subject to which indebtedness the corporation or individual holds property.

If there is unamortized premium or discount as of the first day of the tax year in which a discharge of indebtedness occurs, the premium is excluded from gross income, and the discount is not allowed as a deduction.

Line 2.—You may elect to apply any part of the amount excluded from gross income under section 108(a)(1)(A) and (B), relating to discharge of indebtedness of insolvent or bankrupt taxpayers, to your basis in depreciable property under section 108(b)(5). See section 1017 for reductions that may only be made in the basis of depreciable property.

Line 3.—For purposes of reduction of basis of depreciable property in connection with a discharge of indebtedness, you may elect to treat all of your real property described in section 1221(1) as depreciable property. See section 1017(b)(3)(E)

Part II

Adjustment to basis.—Unless the corporation specifically states otherwise, by filing this form the corporation agrees to have the general rule for adjusting the basis of property (as described in section 1.1082–3(b) of the regulations) applied

If the corporation desires to have the basis of its property adjusted in a manner different from the general rule, it must attach a request for variation from the general rule. The request must show the precise method used and the allocation of amounts.

Consent to the request for variation from the general rule will be effective only if incorporated in a closing agreement entered into by the corporation and the Commissioner of Internal Revenue under the provisions of section 7121. If no agreement is entered into, then the general rule will apply in the determination of the basis of the corporation's property. If the corporation specifically states that it does not consent to the application of the general rule, then the document filed is not considered a consent under section 1081(b)(4).

Taxpayer: ____________________ Attachment to Form 1040

SSN/TIN: ____________________

ELECTION OF INDIVIDUAL TAXPAYER TO TERMINATE TAXABLE YEAR UPON COMMENCEMENT OF CHAPTER 7 BANKRUPTCY PROCEEDING (PURSUANT TO INTERNAL REVENUE CODE §1398(d)(2))

BE HEREBY ADVISED, that the taxpayer(s) have filed for protection under Chapter 7 of Title 11 of the United States Code (bankruptcy liquidation); and hereby elect(s) to close his/her/their tax year effective the day before commencement of said bankruptcy proceeding, the ______ day of ___________________, 198___. It is understood that this election shall act to split the taxpayer's calendar year into two short taxable years pursuant to the provisions of Internal Revenue Code §1398(d)(2)(A). Taxable income for each short tax year shall be computed on an annualized basis under the provisions of Internal Revenue Code §443(b).

The taxpayer(s) understand(s) that this election, once made, is irrevocable.

Taxpayer: ____________________ Attachment to Form 1040

SSN/TIN: ____________________

ELECTION OF INDIVIDUAL TAXPAYER TO TERMINATE TAXABLE YEAR UPON COMMENCEMENT OF CHAPTER 11 BANKRUPTCY PROCEEDING (PURSUANT TO INTERNAL REVENUE CODE §1398(d)(2))

BE HEREBY ADVISED, that the taxpayer(s) have filed for protection under Chapter 11 of Title 11 of the United States Code (bankruptcy liquidation); and hereby elect(s) to close his/her/their tax year effective the day before commencement of said bankruptcy proceeding, the ______ day of ___________________, 198___. It is understood that this election shall act to split the taxpayer's calendar year into two short taxable years pursuant to the provisions of Internal Revenue Code §1398(d)(2)(A). Taxable income for each short tax year shall be computed on an annualized basis under the provisions of Internal Revenue Code §443(b).

The taxpayer(s) understand(s) that this election, once made, is irrevocable.

Taxpayer: ____________________
SSN: __________________________

Attachment to
Form 1040

CALCULATION OF ANNUALIZED INCOME PURSUANT TO INTERNAL REVENUE CODE §443(b)

Step 1: Modified Taxable Income

a. Adjusted gross income $
Less: Itemized deductions __________

$

b. LESS:
Personal exemptions x $\frac{\text{no. mos. in short yr.}}{12}$

$\$$__________ x $\frac{\text{__________}}{12}$ = $__________

Modified Taxable Income $__________

Step 2: Annualized Income

a. Modified tax. income x $\frac{12}{\text{no. mos. in short yr.}}$

$\$$__________ x $\frac{12}{\text{__________}}$ = $

b. Add: Zero bracket amount __________

Annualized Income $__________

Step 3: Tax Liability

Tax liab. on annualized inc. x $\frac{\text{no. mos in short yr.}}{12}$

$\$$__________ x $\frac{\text{__________}}{12}$ = $__________

NOTE: The taxpayer must itemize deductions when filing a short tax year return and annualizing income.

NOTE: Self-employment tax is calculated on actual self-employment income.

BALANCE SHEET/DATA ACCUMULATION WORKSHEET

Debtor ______________________________ Date ______________

Individual ___ Partnership ___ Corporation ___ Other ___

I	II	III	IV Gain/Income Classification		
Item Description	Fair Value	Adj. Basis	1001	108	1245/1250
Assets					
Quick Assets					
Cash					
CSV of Life Insurance					
Business Accts Rec.					
Bonds & Stock					
Prepaid Expenses					
Other ______					
Livestock					
Number Weight Ind Value					
Cattle					
Hogs					
Other					
Grain & Farm Products					
Corn ______ bu. at $______					
Bean ______ bu. at $______					
Hay ______ bales at $______					
Cars, Trucks & Equipment					
Machinery & Equip. (attach schedule)					
Other ______					
Other ______					
Real Property/ Contracts					
Personal Residence					
Land					
Buildings					

William S. Vernon
MOYER & BERGMAN
Attorneys at Law
Cedar Rapids, IA 52402

I	II	III	IV		
			Gain/Income Classification		
Item Description	Fair Value	Adj. Basis	1001	108	1245/1250
Contracts Rec.					
TOTAL FAIR MARKET VALUE OF ASSETS*	$______				
Liabilities					
Operating Loans:					
Bank ______					
Principal ______					
Interest ______					
Bank ______					
Principal ______					
Interest ______					
Other ______					
______					
Accounts Payable:					
Fertilizer Payable					
Chemical Payable					
Labor Payable					
Federal Taxes Payable					
House Payment					
Judgments					
Life Ins. Loan					
Equipment Loan ______					
Equipment Loan ______					
______					
______					
Long term debt:					
Lender					
Mtg. (Acres ______) (______)					
Mtg. (Acres ______) (______)					
Mtg. (Acres ______) (______)					

I	II	III	IV
Item Description	Fair Value	Adj. Basis	Gain/Income Classification 1001 108 1245/125
Residence mtg.			

TOTAL LIABILITIES ( )
*TOTAL ASSETS (from above) ____________
TOTAL NET WORTH (DEFICIT) $____________

Footnotes

1. Denotes potential capital gain (Total $______________)
2. Denotes potential 1245/1250 recapture (Total $______________)
3. Denotes potential income from discharge of indebtedness excludible under Section 108 (Total $______________)
4. Denotes non-recourse debt (Total $______________)
5. Denotes investment tax credit recapture (Total $______________)

****

Tax Attributes Summary

Net Operating Loss - current year ______________
Net Operating Loss - prior years ______________
Tax Credit (inv. tax credit, work incentive credit, new job credit, alcohol fuel credit) Type ________ ______________
Tax Credit Carryover - prior years - Type ________ ______________
Capital Losses - current year ______________
Capital Losses - prior year ______________
*Foreign Tax Credit and Carryovers ______________

APPENDIX PROBLEM 3

1. Taxpayers filed a Chapter 7 bankruptcy on January 27, 1984. A copy of Schedules "A" and "B" attached to taxpayers' petition in Bankruptcy Court indicate that at the time of filing of the petition taxpayers had total secured indebtedness in the amount of $128,000 and unsecured debts in the amount of $94,000 for a total indebtedness in the amount of $222,000. At the same time taxpayers owned property consisting of farm machinery, equipment and livestock, as well as, non-business personal property in the total value of $105,000. A telephone call to the clerk of the Bankruptcy Court revealed that taxpayers were discharged from their indebtedness on October 9, 1984, and the case was closed December 18, 1984.

INSOLVENCY:

Assets			105,000
Liabilities:	Secured	128,000	
	Unsecured	94,000	
			222,000
	Net Worth		($117,000)

2. A telephone call to taxpayers' bank reveals that the total secured indebtedness listed on the bankruptcy schedules ($128,000) included accrued interest of approximately $13,300.

§108(e)(2): No discharge of indebtedness income
$13,300.

3. A review of the bankruptcy schedules of the taxpayers reveals that two of the debts being discharged were loans from family members that were used to pay rent and other operating expenses. In addition, indebtedness totaling $33,000 were debts for fertilizer, chemicals, seed and other operating expenses.

§108(e)(2): No discharge of indebtedness income
$33,000.

4. A telephone conversation with the attorney who filed the bankruptcy on behalf of taxpayers indicates that no tax returns were filed on behalf of the bankruptcy estate, and in all probability no notice was given to the Internal Revenue Service of the filing of the bankruptcy. Taxpayers did not elect to terminate their taxable year prior to the bankruptcy filing date.

5. During the bankruptcy proceedings, taxpayers purchased all of their farm machinery from the bank which held the security interest in the machinery. The taxpayers paid the bank $36,000 for the machinery utilizing newly borrowed funds. The farm machinery had previously been abandoned by the trustee as burdensome.

6. (Material not complete.)

reveals that after liquidation of the assets in which the bank held a security interest, the amount of principal which was charged off on taxpayers' account was $18,000, exclusive of the accrued interest ($18,000 + $13,300 = $31,300 Total).

7. Taxpayers' tax attributes on January 1, 1984, consisted of a net operating loss carryforward in the amount of $45,000 and investment credit carryforward in the amount of $2,000.

8. Taxpayers' farming operation for the year 1984 reported an additional loss, on Schedule F, in the amount of $30,000. Taxpayers reported an adjusted gross income of ($24,000) for the year on Form 1040. No Section 1398 election was made.

Question: What are the tax consequences of the above, considering §1398 and §108, and in particular §108(e)(2)?

ANSWER: Paragraph 1 of this problem states that the taxpayers were discharged from bankruptcy on October 9, 1984 and the bankruptcy case was closed on December 18, 1984. However, when the trustee fails to file tax returns, we are not able to determine when the taxable year of the bankruptcy estate ends for the purpose of making adjustments to carryforward tax attributes for use in preparing tax returns for the debtor. In this situation, it must be assumed that the taxable year of the bankruptcy estate ended in 1984 so that the adjustment to attributes would occur in 1984 and be passed back to the taxpayer prior to the year's end. §1398(i).

Also, the basis of property which the taxpayer has at the time of discharge may need to be adjusted following discharge. When a discharge occurs in bankruptcy, it is the taxable year of the bankruptcy estate in which the discharge occurs which determines the timing of the adjustment of the basis resulting from excess debt discharge income.

Paragraph 2 of the problem specifies that one of the debts discharged was incurred for accrued interest. Pursuant to §108(e)(2) no debt discharge income is incurred for such expense.

Paragraph 5 of the problem indicates that the taxpayer-debtor paid the bank $36,000 to reacquire his farm machinery. This does not amount to a purchase of the machinery which would establish a new cost basis. This purchase was a mere payment on debt owed to the bank. Accordingly, because the machinery represents property abandoned or transferred by the trustee to the debtor, the basis of the property in the hands of debtor must be reduced by excess debt discharge income. Had the taxpayer purchased the property from the estate, the adverse result would not have occurred.

Paragraph 6 of the problem indicates that there was a difference in the amount of debt charged off by the bank, and the amount listed in the debtor's schedules attached to the petition in bankruptcy. The amount of indebtedness to be used in the computation of 108(a) amount, does not necessarily depend on the amounts as stated in the schedules attached to the petition in bankruptcy.

DISCHARGED INDEBTEDNESS

§108(a) Amt.		
Bank debt - principal	$18,000.	
Family loans (unsecured)	33,000.	
Other debt (unsecured)	24,000.	
Subtotal		75,000.
NOL Cfwrd		(45,000.)
ITC x 2		(4,000.)
Bal. to reduce A/B of property		26,000.

This $26,000 amount used to reduce the basis of property held by the taxpayer is applied on the first day of the taxable year following the year of the discharge, keeping in mind that the taxable year referred to is that of the bankruptcy estate. As indicated above, the taxable year of the estate is not known as no returns were filed. For the purposes of debtor's return preparation for the taxable year 1984, it must be assumed that the taxable year would end prior to the time at which the bankruptcy case was closed. Accordingly, the basis of property held by the debtor would be adjusted prior to the computation of 1984 income tax. The payment of the $36,000 to the bank merely reduces the amount of the §108 debt discharge income and does not increase the taxpayer's basis in the property.

THE
IOWA STATE BAR ASSOCIATION

TAXATION COMMITTEE
Orville Bloethe, Chairman
702 3rd Street
Victor, Iowa 52347
Telephone 319/647-3121

13 May 1985

Mr. Ronald A. Pearlman,
Ass't. Secretary (Tax Policy)
Department of the Treasury
Washington, D. C. 20220

Dear Mr. Pearlman:

Re: Alternative minimum tax and related matters

Thank you for the courtesy extended to David Bibler, James Shepard and myself together with Senator Grassley, Congressman Cooper Evans, attorney Ben Hartley and other staff members in connection with the meeting held in your office on Friday afternoon, April 19, 1985. The purpose of this letter is to set forth our concerns and the reasoning for such concerns. Same are as follows:

1. CERTAIN CAPITAL GAINS OF INSOLVENT TAXPAYERS SHOULD BE EXCLUDED FROM THE ALTERNATIVE MINIMUM TAX.

   S.F. 418 introduced by Sen. Charles Grassley (and H.R. 506 introduced by Rep. Cooper Evans(of Iowa, would provide that the gain resulting from the transfer of property to a creditor in cancellation of a debt or from the sale or exchange of property under threat of foreclosure should not be taken into account in computing net capital gain if immediately before such transfer, sale or exchange the taxpayer is insolvent (as defined in section 108(d)(3). The amendment would be retroactive to apply to transfers, sales or exchanges made after December 31, 1981.

   The problem arises repeatedly in Iowa and in other agricultural states where property with a low adjusted basis is subjected to forfeiture or foreclosure and where the indebtedness is considerably in excess of the adjusted basis. Income tax may be alleviated by reason of income averaging or investment tax credit carryover, but the alternative minimum tax that results is significant. The net effect is that oftentimes the debtor is stripped of all property and winds up with alternative minimum tax imposed by section 55 of the Internal Revenue Code simply because such unwary taxpayer did not resort to the bankruptcy court. The fact that funds might not have been available to take that additional step or the taxpayer was unaware of the tax consequences seems insufficient reason to saddle such taxpayer with a tax which may well never be collectible, or if collectible, would impose an almost intolerable burden.

If the alternative minimum tax simply did not result where there was such insolvency, and same was further restricted to a trade or business which would exclude tax shelters from such benefit, it seems to us as though the real purpose of the Internal Revenue Code would be furthered without any significant decrease in revenues.

2. BY TREASURY REGULATIONS OR BY OTHER APPROPRIATE TREASURY ACTION, THE PROBLEM CREATED BY COMMISSIONER V. TUFTS, 103 S.Ct. 1826 (1983), SHOULD BE RESOLVED.

Example 7 of Treasury Regs. 1.1001-2(c) follows the Tufts case. On the other hand, Treasury Regs. 1.1001-2(a)(2) and 1.1017-1(b)(5) take the contrary position. The Tufts decision indicates that the total amount to be considered as having been realized in the transfer of land that is subject to debt shall be the full amount of the debt which is satisfied. In other words, where the basis is less than the debt the entire sum is gain. The said Example 7 takes the same position. On the other hand, the two regulations quoted above indicate that where there is a satisfaction of debt which results in debt discharge income under section 108, then the amount of the debt in excess of fair market value shall be considered as debt discharge income subject to the nonrecognition provisions of section 108 and the basis adjustment requirement of section 1017.

The foregoing apparent conflict creates problems in determining what standard of measure shall be utilized. The tax preparer is placed in an impossible position. Tax policy needs to be clarified. There is no apparent reason for the difference in treatment, and it would appear as though Example 7 of Treasury Regs. 1.1001-2(c) should be withdrawn and there should be clarification that the Tufts decision should not be followed.

A careful reading of the Tufts case indicates that the Court did not consider same a cancellation of indebtedness.

This presumably was true since the debt survived. The debt was not extinguished as such. Should this be the guideline? If so, same needs to be clarified in explicit terms so the practitioner has guidelines. A logical follow-up question might be, "Is it good tax policy to have different tax treatment where the debt is discharged where recourse debt is involved, as compared with the situation where there is non-recourse debt and the debt continues with the property but not as to the taxpayer?"

3. PROPERTY ABANDONED BY THE TRUSTEE IN BANKRUPTCY AND THEREAFTER FORFEITED OR FORECLOSED SHOULD BE AFFORDED THE SAME TREATMENT AS IF SOLD IN THE BANKRUPTCY PROCEEDINGS.

The common, and apparently always followed procedure in Chapter 7 bankruptcy is abandonment of the property by the bankruptcy trustee where the value of the property is less than the indebtedness securing same. The result is that most of the assets may well be abandoned by the trustee, and hence such property is thereafter subjected to either forfeiture or foreclosure. At this point the property is in the hands of the taxpayer and such taxpayer is then subjected to the same tax consequences as if the taxpayer had not resorted to the bankruptcy court. Adverse tax consequences follow and with complete inability to pay.

Where a taxpayer resorts to the bankruptcy court, such taxpayer is necessarily insolvent. Where abandonment of property by the trustee thereafter results, the tax consequences of resulting forfeiture and foreclosure should be as if same were completed within the bankruptcy proceedings itself and the taxpayer shielded from such tax consequences. It is pointless to have tax consequences with inability to pay. The purpose of the bankruptcy proceedings will be defeated to the extent that income tax consequences result by such abandonment.

4. IT IS IMPERATIVE THAT TAX RETURNS BE COMPLETED WITHIN THE BANKRUPTCY PROCEEDINGS FOR THE TAXPAYER TO HAVE THE NECESSARY INFORMATION TO PROPERLY REPORT THE TAX CONSEQUENCES.

Within the bankruptcy proceedings, it is common practice that the trustee does not complete the tax returns. Two specific federal law provisions, 31 USC 3713(b) and 31 USC 192, both provide that the trustee in bankruptcy shall not be personally liable for the income taxes of the estate. As a result, such trustee does not file, except in perhaps rare instances, a tax return. As a result, two significant tax problems occur:

A. One does not know the extent to which tax attributes must be reduced, and

B. One does not know when the tax year and the bankruptcy terminate, which determines when a reduction in basis of property under the provisions of section 1017 would result.

With tax returns not filed and with a complete lack of information as to what reduction must be made in tax attributes and when there should be a reduction in basis of property under section 1017, the question might well be asked, "What is the taxpayer to do?"

In the bankruptcy proceedings, the taxpayer coming out of bankruptcy is simply without guidelines insofar as tax consequences are concerned. Even if there is no personal liability for the trustee, a tax return might be the most direct and straightforward way to handle the matter. At the very least, there should be a detailed report of the significant tax events and the resulting tax consequences (the equivalent of a tax return), and same should be made available to the taxpayer.

We believe that, except for Proposition No. 1 which requires legislative action, the remaining matters may well be taken care of administratively within Treasury. We further believe that all of the foregoing can be accomplished without any significant loss of revenue. Attention to all of the foregoing would add a great deal of certainty to an area of the law that is now fraught with uncertainty. Same leads to further frustration with our already extremely complex tax law.

Our group stands ready to assist in any way in giving further input or background information that might be helpful. Thank you kindly for your consideration.

Very truly yours,

IOWA STATE BAR ASSOCIATION
TAXATION COMMITTEE

Orville W. Bloethe, Chairman

OWB:bv

STATEMENT
CHARLES E. GRASSLEY
UNITED STATES SENATOR

MR CHAIRMAN: I AM PLEASED TO HAVE THIS OPPORTUNITY TO JOIN WITH MY COLLEAGUES IN THE HOUSE OF REPRESENTATIVES IN MAKING A STATEMENT FOR THE RECORD ON SOME OF THE IMPORTANT PROBLEMS WHICH CONTINUE TO IMPEDE REVITALIZATION OF THE FARM ECONOMY IN OUR STATE OF IOWA.

IN MY CAPACITY AS A MEMBER OF THE SENATE COMMITTEE ON FINANCE I HAVE MADE IT MY FIRST PRIORITY TO BRING TO THE ATTENTION OF MY SENATE COLLEAGUES THE OFTEN DELETIRIOUS EFFECT OF THE TAX CODE ON THE AGRICULTURAL SECTOR OF THE ECONOMY. LAST YEAR, I WORKED TO PASS A NUMBER OF PROVISIONS IN THE SENATE WHICH WOULD HAVE BENEFITED OUR FARM ECONOMY. THE FIRST WAS A BILL PROVIDING SOIL AND WATER CONSERVATION CREDITS. IN ORDER TO RAISE THE REVENUE TO OFFSET A REVENUE LOSS ATTRIBUTABLE TO THESE CREDITS, A PROVISION WAS INCLUDED WHICH WOULD HAVE REQUIRED AN EXTENSION OF THE DEPRECIABLE LIFE OF SINGLE PURPOSE AGRICULTURAL STRUCTURES. THIS LEGISLATION HAS BEEN REINTRODUCED THIS SESSION. WHILE THIS MEASURE PASSED THE SENATE, IT WAS LATER DROPPED BY THE SENATE-HOUSE CONFERENCE COMMITTEE. I WOULD BE PLEASED FOR OTHER MEMBERS OF THE IOWA DELEGATION TO WORK ON SIMILAR LEGISLATION IN THE HOUSE WHICH IF PASSED BY BOTH HOUSES WOULD HAVE A FAR BETTER CHANCE OF FINAL PASSAGE BY CONGRESS.

LAST YEAR I ATTEMPTED TO AMEND THE 1984 DEFICIT REDUCTION ACT WITH A PROVISION WHICH WOULD HAVE ELIMINATED THE CAPITAL GAINS AS A TAX PREFERENCE ITEM FOR INDIVIDUALS SELLING PROPERTY IN DROUGHT AFFECTED AREAS. I REINTRODUCED SIMILAR LEGISLATION EARLY THIS SESSION WHICH ELIMINATED CAPITAL GAINS AS A TAX

PREFERENCE ITEM IN THE CASE OF A FORCED SALE BY AN INSOLVENT TAXPAYER. I HAVE WORKED CLOSELY WITH CONGRESSMAN EVANS, THE ASSISTANT SECRETARY OF THE TREASURY RONALD PEARLMAN, AND DISTINGUISHED MEMBERS OF THE IOWA BAR ASSOCIATION TO BRING ABOUT ADMINISTRATIVE RELIEF BY REGULATION, AND TO CRAFT THE APPROPRIATE LEGISLATIVE LANGUAGE TO REDRESS THIS PROBLEM FACING TOO MANY OF OUR FARMERS. I AM CONFIDENT THAT A CONTINUED, AND CONCERTED EFFORT IN BOTH THE HOUSE AND SENATE CAN RESULT IN A SOLUTION TO THIS INEQUITY. THE ALTERNATIVE MINIMUM TAX PROVISIONS WERE NEVER INTENDED TO RESULT IN TAX LIABILITY IN THIS SITUATION. HOWEVER CONSISDERING THE ALTERNATIVE MINIMUM TAX PROVISIONS CONTAINED IN THE PRESIDENT'S RECENTLY RELEASED PROPOSAL WE MUST WORK TO ENSURE THAT NO TAX PLAN IS PASSED WHICH FAILS TO REDRESS THIS CRITICAL TAX PROBLEM FOR OUR FARMERS, BEING FORCED TO LIQUIDATE THEIR ASSETS.

I AM PLEASED TO SAY THAT IMPORTANT FIRST STEPS HAVE ALREADY BEEN MADE TO ENACT LEGISLATION WHICH ELIMINATES THE TAX ADVANTAGES FOR INVESTORS IN CATTLEFEEDING TAX SHELTERS.

DURING FINANCE COMMITTEE CONSIDERATION OF THE DEFICIT REDUCTION PACKAGE, THE DEPARTMENT OF TREASURY RECOMMENDED THE ELIMINATION OF ANY PREPAID EXPENSES BEFORE ECONOMIC PERFORMANCE OCCURRED. MANY MEMBERS OF THE COMMITTEE REJECTED THIS BROAD APPROACH TO STOP THE MISMATCH OF INCOME AND EXPENSE. VALID BUSINESS REASONS EXIST FOR PREPAYMENT. IN AGRICULTURE, SMART FARMERS AND RANCHERS BUY FERTILIZER, SEED AND FEED IN THE FALL WHEN THE

PRICE IS LOWER WHICH WILL BE USED THE FOLLOWING SPRING. THIS ACCEPTED BUSINESS PRACTICE HELPS FARMERS REDUCE THIS COSTS AT A TIME WHEN IT IS VERY DIFFICULT TO EARN A PROFIT FARMING.

TREASURY ACKNOWLEDGED THE VALID BUSINESS PURPOSE OF PREPAYING EXPENSES IN AGRICULTURE, BUT EXPRESSED CONCERN THAT WEALTHY INVESTORS SEEKING TO REDUCE THEIR TAX LIABILITY AT YEAR END WERE INVESTING IN CATTLE TAX SHELTERS WHICH USED PREPAID EXPENSES TO OBTAIN AN $8 DEDUCTION FOR EACH $1 INVESTED. ACCORDING TO THE IOWA CATTLEMEN THE PRESENCE OF THE TAX SHELTER INVESTORS WAS CAUSING PROBLEMS IN THE INDUSTRY. TRADITIONAL CATTLEMEN WITHOUT "SHELTER CATTLE" WERE HAVING GREAT DIFFICULTY COMPETING AGAINST CATTLEMEN WHOSE CUSTOMERS WERE NOT MOTIVATED BY PROFIT. CATTLEFEEDERS WITH TAX SHLELTER INVESTORS HAVE A READY SOURCE OF CAPITAL, WHILE TRADITIONAL CATTLEMEN ARE FORCED TO BORROW MONEY AT THE BANK AND PAY AN INTEREST RATE OF 14 PERCENT. MANY CATTLEMEN WHO HAVE TO MAKE A PROFIT ARE HAVING DIFFICULTY COMPETING WITH TAX SHELTER OPERATORS WHO HAVE LOWER CAPITAL COSTS AND NO PROFIT MOTIVE.

TO ADDRESS THIS PROBLEM WITHOUT HARMING LEGITIMATE PREPAYORS IN AGRICULTURE, WE CRAFTED A RULE TO LIMIT PREPAID EXPENSES TO 50 PERCENT OF AN INDIVIDUAL'S FARMING EXPENSES DURING THE TAXABLE YEAR. FARMING EXPENSES INCLUDE THE OPERATING EXPENSES OF THE FARM INCLUDING THE TRADE OR BUSINESS EXPENSES CLAIMED UNDER SECTION 162, INTEREST AND TAXES PAID, DEPRECIATION AND

OTHER EXPENSES LISTED ON SCHEDULE F.

IN VIEW OF THE CURRENT ATMOSPHERE OF TAX OVERHAUL, OUR TASK AS REPRESENTATIVES OF AN AGRICULTURAL CONSTITUENCY IS PARTICULARLY CRITICAL. IT IS ESSENTIAL THAT WE WORK TOGETHER TO ENSURE THAT BONA FIDE FARMERS ARE NOT DISADVANTAGED BY A TAX PROPOSAL THAT SEEKS TO REDRESS ABUSES FROM WHICH THEY HAVE NOT BENEFITTED.

May 31, 1985

Representative Berkley Bedell:

Thank you for the opportunity to testify at this hearing on the tax laws as they relate to farming. In order for you to have a better understanding of my point of view, I would like to give you a brief review of my background.

I was born 61 years ago on the same location that I now live. The original farm of 180 acres was purchased by my grandfather 97 years ago and has been continuously farmed by three generations of my family. Livestock has always been a part of our farming operation. I presently own, or make payments on 331 acres, and I rent 334 acres of grade A land in O'Brien County. Our beef feeding facilities will accomodate up to 800 head of cattle. Of this number, 320 are in confinement. The rest of the cattle are on concrete and have shelter. I use a large amount of forage in my feed ration and we normally have 90 acres of alfalfa each year, plus 30 acres of oats which are used for forage and as nurse crop. Good conservation practices have kept soil erosion at a minimum and have maintained a maximum slope of less than three precent on my land.

I have been on this farm all of my life except for the two and one-half years I served in the U.S. Army during World War II, the four years I spent earning a Bachelor or Science degree in Agricultural Engineering at Iowa State University, and the three and one-half years I worked as an engineer for Harverstore Products, Inc.

We farmers live in a very competitive world. I am in favor of that, but I feel it should be fair competition. I do not believe we have that kind of competition in the beef feeding industry. We find ourselves at a place where we are struggling just to exist or hang on today.

When I first made use of investment credit, it seemed like a good idea. However, I began to question its impact about eight years ago. I have designed feed lots throughout the United States and became aware of the influence that investment credit had on money spent for expansion. I also became a victim of the tax incentive. When income is good, spending money reduces taxes. In my case I borrowed money to purchase items which would earn investment credit.

My federal tax returns will definitely show this relationship and a quick review of my tax returns is as follows:

Year	Income	Fed. Tax Due	Inv. Credit	Fed. Tax Pd.
1978	74,286.00	25,216.00	3,858.00	23,153.00
1979	97,590.00	35,279.00	8,939.72	28,110.25
1980	5,064.00	506.00	0	506.20
1981	-2,132.00	-106.00	623.00	-106.00
1982	49,646.00	11,389.00	2,667.00	8,672.00
1983	15,712.00	639.00	553.00	639.00
1984	-49,473.00	-	0	-

The above figures do not show income averaging and recapture of investment credit but they do show how investment credit increased when income increased. I also have approximately an annual depreciation of $35,000 which is included in the above figures.

Our tax system encourages people with high incomes to use this tax break. The expansion of cattle feeding facilities, especially in Texas and Kansas, would not have occurred nearly so quickly had there been a limit of $5,000 per year for agricultural investment credit.

Investment tax credit becomes abused when investers can sell and reorganize and take the credit again. I wonder how many times this scheme has been used on the same facilities!

Capital gains are also working against low and middle income farmers. These taxes are for the benefit of those in the high tax brackets. I personally know of a wealthy person whose main income is other than agriculture, who bought heifers, bred and sold them after they had calved so he could use capital gains. I question if he actually made anything on this operation, but he was after the capital gains to reduce his income tax.

I dislike being suspicious but I question the wisdom of having a period of only six months for qualifying capital gains. This is an advantage for the speculator. When one purchases something and sells it within six months, I call it speculation. I also question capital gains treatment for stocks. It seems that this could be used as a tax shelter or loophole for corporate livestock operations.

We know that some very influential or wealthy people have had buyers purchase cattle for them to place in commercial lots. One order was supposed to have been for 90,000 head. Such an order greatly increases the price of feeder cattle. I am told these investers put these cattle into a feed lot with the stipulation that monetary losses not exceed a certain amount. This I can not understand, but I certainly can see how deferring tax would be to their advantage.

Custom hog feeding has become quite popular in my area during the past 2 years. It appears there is a tax advantage to wealthy investors when a 220 pound hog, ready for market in November, is held over until the next year for tax purposes. This is not economically practical for efficient livestock operations. This tax incentive creates excess pounds of over fat meat for the market place and thus depresses the price.

One has to have much faith in the future to be a farmer. We have dreamed of building a unit which we thought could support two families. We raise most of our feed for the cattle and attempt to be as efficient as possible. We are not afraid of work. Our dream for the future of our farming operation is shattered by the unfair use of capital gains and investment credit by people whose only objective is reducing their income tax.

I again wish to thank you for your interest in the tax laws and their effect on the farmer. I would like to leave you with this question. "Should the farming business be forced into the situation where it can only exist with external subsidation or should it be allowed to exist in an environment of fair competition and equal opportunity?"

Sincerely,

Paul Linder

Paul Linder
Route 1 Box 12
Hartley, Iowa 51346
Tel. 712 728 2528

To- House Agriculture Subcommittee:

I am opposed to all forms of tax credits - fast depreciation etc.. Just write a tax law and let it go across the board to everyone - rich & poor, individual and corporation.

However, I read in the paper Reagon's program has already been watered down by retaining fast depreciation for hog bldg. & etc.

No legitimate family farmer needs fast depreciation on buildings and other major investments because his income isn't big enough.

Mr. Bedell I mentioned tax shelters to you at a meeting about 1½ years ago at the Cerro Gordo Co. courthouse - you didn't seem very concerned. I hope that you are now.

Delmar Aastrup
RR 1 Box 383
Clear Lake, Iowa 50428

June 1, 1985

Representative Berkley Bedell
6th District, Iowa
Washington, D.C.

Dear Representative Bedell,

We, of the Iowa State Grange and the National Grange think that the "farm tax code" and the present farm crisis are closely related.We are referring to investment credit, accellerated depreciation, cash accounting and capital gains treatment of the sale of breeding stock. We probably all asked for these tax concessions and have benefitted to a certain extent. We are now finding that we have attracted outside non-farm investors to our agricultural industry. These wealthy investors, sometimes companies and sometimes wealthy individuals are using the "farm tax code" to shelter non-farm income from taxation.

The result is that we, as a whole are producing more than we have a market for at profitable prices, here and abroad now and in the forseeable future.

We have seen the poultry industry dominated by feed companies and investors. We are seeing the cattlefeeding industry drift toward investor owned yards in the west and south. We are seeing investors and feed companies putting up 5000 sow farrowing units and market hog facilities at an accellerating rate. We are seeing millions of acres of rangeland being row cropped by using tax subsidized irrigation systems and subsidized water.

As a result of these tax subsidized developments we family farmers are losing control of our industry.

When I said I thought the "farm tax code" was closely related to the "Farm crisis issue" I pose the question; Were these tax related benifits a factor when we made the decision to buy larger machinery, buy or rent more land or build expensive livestock confinement facilities?

According to the 1984 Iowa Farm Poll, conducted by Paul Lasley, Extension sociologist at Iowa State University, 84% of the respondents favor changing the tax code--67% strongly support it and 17% are somewhat supportive 5 % were unsure and 11% were opposed placing limits on farm losses to offset non-farm income.

A recent USDA publication predicts that if current trends continue, by the year 2000 less than 20,000 farms will account for over half of all farm production, compared to the over 160,000 farms today.

Many of us as individuals and through our farm and commodity organizations have supported tax rules, which while beneficial to each individual farmer have been counter-productive in terms of the whole system. These tax policy changes of recent years have brought about unintended effects.

Earl Heady, agricultural economist at Iowa State University, put the current situation this way: "American society needs to decide whether it wants a few large farms scattered along over rural space or whether there are other values relating to rural space which are best maintained by an efficient set of modest-sized family farms. Unless public policy is changed soon, family farms as most people know them may disappear completely from agriculture. The agricultural public and the society at large need to hurry to make a decision on whether it is going to let the trend to superfarms continue."

According to V. James Rhodes, University of Mo. Ag-Economist the "impact of the tax sheltering on competitive position has been partly responsible for the shift of the cattle feeding out of the hands of the farmer feeders." USDA says 3/4 of the nations cattle are now fed in large commercial and custom feedlots."

There is growing evidence that investment credit and five year depreciation on single purpose dairy buildings, cash accounting and the capital gains tax sheltering opportunities are having a negative effect on the family farmer dairyman.

Harold Breimyer, Agricultural Economist, University of Mo. says, "The net effect (of tax laws) is to throw almost insuperable roadblocks in front of under-financed capable young farmers as assets are priced out of their reach....I suspect tax laws cause young, debt-burdened farmers actually to subsidize their well-financed competitors.

Let's be honest. There is no chance of preserving family farming if tax laws are not changed....By the same token, although much is heard about estate taxes...a sharply graduated estate tax is an essential part of any policy to retain family farming."

"The Inter-religious Task Force on U.S. Food policy views with alarm the conclusions reached by many experts regarding federal tax policy and the future of the family farm system of agriculture"

This is the Inter-faith statement on public policy and the structure of agriculture by fourteen religious denominations: "Many of the religious traditions we represent have taken public policy positions of the plight of the family farm. Drawing from the concern of of our respective fellowships, we declare our support for public policy that would:
Restructure tax laws...so as to strengthen an agriculture based primarily on small and moderate-sized family farms. This involves eliminating incentives that favor large units, stimulate absentee ownership, or encourage corporate control of resources".

In conclusion, these tax provisions which benefit small farmers in the short run soon become obstacles to their survival in the long run!

Dr. Norman Borlaug, the Iowan who won the Nobel Prize for his work in developing the "Green Revolution", recently returned to the United States after 40 years abroad is shocked by what is happening in rural America. He said the U.S. is headed either a "landed aristocracy" or a "corporate aristocracy". He said, "I hope our political and educational leaders are smart enough to look far enough ahead."

Each month and year that we delay this tax reform more thousands of family farmers will be forced out of their chosen livelihood because lack of profit in their livestock and grain enterprises. This is caused by over-production by those wealthy investors who seek to shelter their income from taxation.

We just came back from the governors conference on "Agriculture in Transition" in which we saw interviews with farm families who have been forced to leave the farm flashed on a screen. Grown husbands, wives and even their children broke down and cried at the feelings of frustration and the feelings that they have failed.

The corporate structure has no soul!!!

Thank you for asking the Grange to participate in this hearing. We were unable to attend on short notice, but did want to present our views.

Sincerely,

Ross

Ross Mintle, Legislative Director of
Iowa State Grange
Malcom Iowa, 50157

State Grange Master-Charles Routier
Leg. Committee members,
Eric Pederson
Chris Harris

TO WHOM IT MAY CONCERN:

I am deeply concerned about the hardship caused many farmers and small businesses when a lender takes over mortgaged property in forgiveness of debt. The farmer in some cases, if he has a low bases in his property, may then be obligated to a large income or capital gain tax with no money to pay it. Simply stated, if he had the funds to pay this income or capital gains tax on the transaction, he would have had the money to make his farm payment, thus eliminating the need for lender take over. It seems a tragedy to force people into Bankruptcy Proceedings just to satisfy this situation's tax obligation.

The stress of losing one's farm or business is devastating enough without the unthinkable pressure of government tax laws and power pounding at an individual to pay taxes on a transaction where he realized no income to pay them with.

Ken Scott
RR 2
Clear Lake, Ia. 50428